NO. 15293

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CEDAR CREEK OIL AND GAS COMPANY, a corporation;
INTERNATIONAL TRUST COMPANY, a corporation;
H. C. SMITH; SUSAN M. WIGHT; and W. B. HANEY,

Appellants,

vs.

FIDELITY GAS COMPANY, a corporation;
MONTANA-DAKOTA UTILITIES COMPANY, a corporation;
and SHELL OIL COMPANY, a corporation,

Appellees.

BRIEF OF APPELLEES

Appeal from the United States District Court for the District of Montana
Billings Division

Of Counsel::

Faegre & Benson
1260 Northwestern Bank Bldg.
Minneapolis 2, Minnesota

Coleman, Lamey & Crowley
500 Electric Building
Billings, Montana

Of Counsel for Defendant,
Shell Oil Company

Howard M. Gullickson
1700 Broadway
Denver, Colorado

Charles N. Wagner
1700 Broadway
Denver, Colorado

John C. Benson
Armin M. Johnson
Rodger Nordbye
1260 Northwestern Bank Bldg.
Minneapolis 2. Minnesota

Raymond Hildebrand
Glendive, Montana

Arthur F. Lamey
500 Electric Building
Billings, Montana

Attorneys for Appellees

INDEX

INDEX (Cont'd)

INDEX (Cont'd)

INDEX (Cont'd)

CASES CITED

CASES CITED (Cont'd)

CASES CITED (Cont'd)

TEXTBOOKS

STATUTES

RULES

NO. 15293

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CEDAR CREEK OIL AND GAS COMPANY, a corporation; INTERNATIONAL TRUST COMPANY, a corporation; H. C. SMITH; SUSAN M. WIGHT; and W. B. HANEY,

Appellants,

vs.

FIDELITY GAS COMPANY, a corporation; MONTANA-DAKOTA UTILITIES COMPANY, a corporation; and SHELL OIL COMPANY, a corporation,

Appellees.

BRIEF OF APPELLEES

Appeal from the United States District Court for the District of Montana
Billings Division

JURISDICTION

On October 15, 1956, appellees moved to dismiss this appeal on the ground that the notice of appeal was filed too late. The motion was denied. (238 F. 2d 299) This Court's attention was not invited to the then unreported *F & M Schaefer Brewing Co. v. United States,* 236 F. 2d 889 (2d Cir., Sept. 12, 1956) involving circumstances closely parallel to those present in the instant case. The Supreme Court has granted certiorari in the *Schaefer* case and it has been placed on the summary calendar. If *Schaefer* is affirmed, this Court might wish to reconsider its jurisdiction.

Deeming appellants' statement of the case inadequate and in some instances inaccurate, appellees present the following:

STATEMENT OF CASE

Pleadings

a. Amended Complaint.
(Tr. 14-55)

The amended complaint consists of twelve causes of action. Each is to quiet title to lands or leases in Fallon County and the allegations are generally the same. Each appellant alleges two causes of action and in one reference is made to the basis of appellees' claim as being:

> "That the defendants claim some right against the lands and leases of the plaintiff, Cedar Creek Oil and Gas Company, a corporation, described above, under and by reason of a lease and operating agreement bearing date of the 7th day of February, 1935," (Par. VII, First Cause of Action. Tr. 17)

The agreements are identical with Exhibit 2 in evidence, except as to names, descriptions and dates. It is sometimes spoken of as the "Deep Test Agreement" because it pertains to operations below the depth of 2,000 feet. In the answer appellees designate it as "Fidelity Operating Agreement."

The other cause of action for each appellant is different only in referring to another document, the Gas Unit Agreement. This is generally referred to as the "Gas Unit Agreement". It is identical with Exhibit 3 in evidence, except as to names, lands and dates and primarily pertains to production of gas from shallow sands.

The statement that "Appellants are the owners of certain lands and leases" on page 2 of their brief is inaccurate. Each appellant claims solely under federal or fee oil and gas leases, and they are not landowners. (Tr. 130-138)

Although the causes of action are in form to quiet title, it is apparent that appellants were seeking cancellation of the Fidelity Operating Agreement and the Gas Unit Agreement insofar as it provides for unitization of formations below the Judith Sands.

b. Answer.
(Tr. 58-98)

The first defense is that the complaint fails to state a claim on which relief can be granted. For a second defense, the appellees answered jointly denying that appellants were in possession of the lands and leases; alleging that appellees are in possession; and specifically setting forth the agreements under which they claim either as parties thereto or successors in interest. It is further alleged that the agreements are in full force and effect. In the answer to each cause of action the agreements are specifically described. (See the answer to the first cause of action for typical allegations. Tr. 58-59).

In addition to the Fidelity Operating Agreement and Gas Unit Agreement previously referred to, the Gas Purchase Agreement (Exhibit 4) and Shell Operating Agreement (Exhibit 5) are set forth. Under the Gas Purchase Agreements, Gas Development Company, predecessor of Montana-Dakota Utilities Company, agreed to buy and appellants agreed to sell natural gas from the lands involved herein. The Shell Operating Agreement invested Shell with the operating rights of Montana-Dakota Utilities Co. and Fidelity Gas Co. in all formations below a depth of 2,000 feet. Fidelity Gas Co. is a fully owned subsidiary of Montana-Dakota Utilities Co.

The third defense is estoppel, the fourth waiver and the fifth laches. (Tr. 60-62)

c. **Reply.**
(Tr. 101-112)

The reply is directed to the agreements referred to in the answer, and generally alleges that the Fidelity Operating Agreements expired under their terms because of failure to drill more wells; if not so terminated they were abandoned; and if not abandoned they terminated because of failure to continue exploration. Estoppel of appellees is alleged in paragraph IV. (Tr. 104-105)

The reply contains certain allegations with reference to the invalidity of the Gas Unit Agreements and Gas Purchase Agreements, which are omitted because at the pre-trial conference it was stipulated that all question as to the validity of these agreements was eliminated; and appellants' contention was limited to the claim that they apply only to the Judith River Sands. (Tr. 116)

At the opening of the trial the third and fourth causes of action pertaining to Mondakota Gas Company, were dismissed on motion of appellants' counsel. (Tr. 231)

STATEMENT OF FACTS

The lands involved are within an area known as the Cedar Creek Anticline in eastern Montana. Maps showing the Cedar Creek Anticline were introduced by stipulation at the pre-trial conference as Exhibits 1 and 1-A. (Tr. 118, 230) These exhibits consist of the official U. S. Geological Survey map, in two parts, with gas units, well locations and other data shown thereon. The lands involved here are in the area designated Unit 5, and are indicated on Exhibit 1 in red shading. They constitute only a part of the land within Unit 5. The other owners and lessees who became parties to the Fidelity Operating Agreement and the Gas Unit Agreement are not before this court. The appel-

lants' lessors, including the United States, are not parties.

Montana-Dakota Utilities or its predecessors were producing gas from the Cedar Creek Anticline at the time the gas purchase agreements, gas unit agreement and Fidelity Operating Agreements, referred to in the answer, were executed. (Tr. 521) Much of the land was government owned and the appellants or their predecessors were being pressed by the government for payment of compensatory royalties, since they were not marketing gas and it was alleged that drainage was taking place. (Tr. 242, 243, 524) To relieve this situation, and with the guidance and help of the United States Geological Survey, a meeting was arranged between most of the appellants, or their predecessors, to discuss the terms of the three types of agreements pleaded in the answer, which were intended to provide for a comprehensive development of the lands within the Cedar Creek Anticline and assure a market for gas. (Tr. 526) The meeting resulted in Montana-Dakota purchasing gas under purchase agreements, development and operation for gas production under gas unit agreements and the exploration for oil and gas below 2,000 feet under the Fidelity Operating Agreements. (Tr. 247, 538)

The memorandum report of this meeting, prepared by H. J. Duncan, supervisor of United States Geological Survey, is in evidence as Exhibit 49. It shows that in addition to four representatives of U.S.G.S., John Wight and George Norbeck, Attorney F. G. Huntington (Wight's attorney), R. M. Heskett, Cecil W. Smith and Attorney Raymond Hildebrand were present. As shown by the report accord was generally reached on the form of gas unit agreements, gas purchase agreements and the "operating agreement designed to provide for the cooperative prospecting and development of oil and gas below 2,000 feet in Cedar Creek Anticline, Montana . . .". The taking of

gas prior to commencement of operations under the Gas Unit Agreement was agreed upon in order to provide "for the payment of monies past due and owing to the United States for compensatory royalty or rentals" (Par. 6, Ex. 49) owing by Wight and his group. (Tr. 538)

Unit 5 is one of several units within the Cedar Creek Anticline. (Tr. 537; Ex. 1) All were formed with approval of the United States, acting through the Secretary of the Interior. (Tr. 536) The easterly and westerly boundaries were dictated by the U.S.G.S., but the lines between units were based largely on the wishes of the interested owners of operating rights. (Tr. 535-538) While some units now cover the deep horizons, Unit 5 Gas Unit Agreement refers primarily to the gas production above 2,000 feet, but commits all parties to unitization of deeper horizons. (Ex. 3, Tr. 538)

In connection with the gas purchases the gas unit agreements were made. (Tr. 247) Through the gas units Montana-Dakota Utilities Co. carried on extensive development for the production of gas in Unit 5 and other units in the Cedar Creek Anticline. (Tr. 521, 523) Under them operations are still being carried on. The lessors under the leases involved, of which the United States is the principal one, are not seeking cancellation. They are not parties to this action.

Recognizing the possibility for development of gas and oil at lower horizons and as part of an over-all development the Fidelity Operating Agreements were entered into with the appellants (Tr. 538, Ex. 2) and others covering about 90% of the lands in the Cedar Creek Anticline. (Tr. 539)

With the Fidelity Operating Agreements executed Fidelity made extensive geological examinations of Cedar Creek Anticline. Geologist Frank W. DeWolf, one-time dean of the Geology Department of the University of Illinois, undertook a

study of the Cedar Creek Anticline. (Tr. 478-480) After completing his work and with the aid of seismographic mapping, which was done on his recommendation, he concluded that the Cedar Creek Anticline was "essentially one structure". (Tr. 485) "It was one structure leading up to a major closed dome at the south end, the so-called—what is it, Little Beaver". (Tr. 486) Based upon these findings N. P. No. 1 was drilled by Fidelity, followed by the Warren and Smith No. 1 Wells. (Tr. 487-491)

Fidelity commenced a test well, N. P. No. 1, in August 1935, and completed it in October 1936. (Tr. 542) Small but non-commercial production was encountered. (Tr. 546-547) Immediately the Warren well was commenced in Unit 5 and completed in January 1937. (Tr. 544) Smith's No. 1 was also commenced in October 1936. (Tr. 544) Much work was done in an attempt to produce these wells commercially during 1938, but without success. (Tr. 546-547) Approximately $450,000 was expended by Fidelity on drilling and geophysical work. (Tr. 542, 543, 545, 547)

During the period 1935 to January 1939 negotiations were carried on between The California Company and officers of Fidelity looking to development of the Cedar Creek Anticline, including Unit 5, under Fidelity Operating Agreements. (Tr. 506-511, 547-551; Ex. 41 and 42) The California Company also did geophysical work on portions of the Anticline. (Tr. 511-512) Finally, California decided not to go ahead with development and on January 9, 1939, so advised Fidelity. (Tr. 512; Ex. 42)

Fidelity entered into two agreements with The Carter Oil Company (Ex. 43 and 44). Exhibit 43 is dated June 6, 1940. and relates to Unit 8. Under the agreement Carter agreed to commence a seismic survey during the summer of 1940 and

within 60 days after its completion either to relinquish the area or drill a well. If it chose to drill, Fidelity agreed to assign and sublease to Carter its rights under the Fidelity Operating Agreement (Ex. 2) and Carter agreed to assume Fidelity's obligations under the operating agreement, and agreed to pay to the lessees and permittees the 25% of the net proceeds provided in the operating agreements.

Exhibit 44 is dated November 27, 1940, and relates to Units 1 to 7, inclusive. Under this agreement Carter acquired the right to extend its operations into these units pursuant to the provisions of the Fidelity Operating Agreement (Ex. 2). If it elected on or before January 1, 1942, to drill a well in one of the units Fidelity agreed to assign and sublease to Carter its rights under the Fidelity Operating Agreement and Carter agreed to pay to the lessees and permittees the 25% of the net proceeds as provided in said Operating Agreement. Under these agreements Carter commenced a well in May 1941 in Unit 8 which was completed in January 1942 as a noncommercial well. (Tr. 552, 554)

By telegram dated December 31, 1941, Carter notified Fidelity that it had decided not to drill on Units 1 to 7, inclusive. (Ex. 45)

Fidelity entered into an agreement with Husky Refining Company (Ex. 46) on November 20, 1948, applicable to Units 8A and 8B. Under its agreement (Ex. 46) Husky drilled a well in Unit 8B which was completed in July, 1949, as a nonproductive well. (Tr. 559-562) It cost $165,964.32. (Tr. 562)

By letter dated November 13, 1948, (Ex. 47) Fidelity agreed with Husky that if it deemed it advisable to negotiate for the development of deeper horizons in Units 1 to 7, inclusive, it would advise Husky of the terms upon which it would begin negotiations. Husky would then have a period of 30 days within

which to accept or reject such terms. This agreement was terminated on May 31, 1950. (Ex. 48)

Early 1950 negotiations began between Shell and Fidelity which resulted in the agreement of April 10, 1951. (Tr. 562; Ex. 5) Shell had expended about $725,000 in geophysical work on the Anticline during 1950, 1951, and 1952, and $600,000 in 1953 and 1954, (Tr. 680-681), including work on the portion of the Anticline lying in Gas Unit 5 (Tr. 664). Under it over fifty-three wells had been drilled at the time of the trial. (Ex. 60) The locations of forty-two are shown on Exhibit 1. Oil has been discovered and is being produced in the north and south ends of the Cedar Creek Anticline and drilling and production are progressing toward Unit 5. (Exhibits 1 and 60) The expenditures for drilling, equipping, producing and operating wells to March 31, 1955, were approximately $12,000,000.00. (Ex. 60)

The Williston Basin Area came to life, so to speak, through a succession of oil discoveries; Amerada near Williston, N. D., in May, 1951; Shell at Richey, July, 1951; Shell on the Pine Unit in north Cedar Creek Anticline in January, 1952; and Shell again in Little Beaver in south Cedar Creek Anticline in July, 1952. (Tr. 643) These last two wells were drilled under the Shell-Fidelity Operating Agreement. (Exhibits 1 and 5)

These successful developments caused a great speculative boom to envelop eastern Montana. (Tr. 645-649) Thomas A. Jirik, president of appellant Cedar Creek Oil and Gas Company, when asked if the drilling of the well by Shell in Little Beaver, a part of Cedar Creek Anticline, created any new interest, replied: "I am happy to tell you it is just a completely different picture with the Shell people doing what they are doing." (Tr. 431) Then followed this question and answer:

"Q. It puts an entirely different complexion on the

whole Cedar Creek Anticline, doesn't it?

A. Absolutely." (Tr. 431-432)

Values of the interests appellants had committed to the agreements suddenly spiralled. Prior to Shell discoveries in the Pine and Little Beaver wells leases had a value of about $2.50 per acre and subsequently they went to $430.00 or an average of between $300.00 and $500.00 per acre. (Tr. 650-654)

Although Wight, Jirik and Seivers testified they had conversations in 1937 and 1938 with Cecil W. Smith and R. M. Heskett in which they were told Fidelity was through with deep tests in Cedar Creek, (Tr. 263-267, 415-419, 452-454), (departing substantially from their prior testimony on that subject in depositions taken in 1953), no request for a release to clear the records was ever made. (Tr. 572)

In 1949 Wight prepared and sent to each of the appellants a form of notice which, in turn, was to be sent to appellees Fidelity and Montana-Dakota, advising that the Fidelity Agreements were no longer valid. (Ex. 21, Tr. 332) The record does not reflect that any of the appellants sent this notice except Cedar Creek, and then not until September 12, 1952, after three producing wells were completed, others were being drilled, and heavy expenditures had been made by Shell. (Ex. 60)

On April 27, 1951, Fidelity and Montana-Dakota by letter advised all of the appellants of the April 10, 1951 operating agreement with Shell and Shell's proposed operations under the Fidelity Agreements. (Ex. 26, Tr. 374)

The only other notice sent to Fidelity or Montana-Dakota was a letter dated July 16, 1951, from appellant H. C. Smith declaring forfeited and cancelled any interests under the old operating agreements. There is no evidence of any such notice from any of the appellants to appellee Shell Oil Company. (Ex. 30)

No notice of forfeiture was ever given to Fidelity. (Tr. 572)

ARGUMENT

Appellants first argue the question of estoppel, laches and waiver. It was upon such findings the lower court primarily rested its decision. The appellees are of the view that an understanding of the provisions, purposes and meaning of the Fidelity Operating Agreement and performance thereunder is of primary importance in considering all questions presented, including estoppel, laches and waiver. The points to be discussed by appellees may be summarized as follows:

1. Review of the Fidelity Operating Agreement with reference to its provisions, purposes, meaning and performance thereunder.
2. The trial court's conclusions that appellants' claims are barred by the defenses of laches, estoppel and waiver are supported by the facts and the law.
   a. The trial court's findings of fact relating to laches, estoppel and waiver are amply supported by the evidence.
   b. Established principles of law support the court's conclusions of law sustaining these defenses.
3. Under the provisions of paragraphs 4 and 6 of the Fidelity Operating Agreement, appellees were permitted to exercise their discretion as to the extent of further drilling, provided they acted in good faith.
   a. Appellants were required to plead and prove Fidelity's lack of good faith in exercising its discretion with reference to further exploratory drilling.
   b. Covenants will not be implied where the standard

of development is expressly covered in the agreement.

4. Appellants were required to give notice of appellees' default, under express or implied duty to drill or develop.
5. The Fidelity Operating Agreements have not, as claimed by appellants, expired under their own terms.
6. The court's finding and conclusion that appellees have not abandoned their rights under the Fidelity Agreement are strongly supported by the evidence.
7. Paragraph 4 of the Fidelity Operating Agreement is not ambiguous and parol evidence concerning its provisions was properly excluded.
8. Appellees are not estopped from claiming under Fidelity Operating Agreements.

1.

Fidelity Operating Agreement

a. Provisions.

It is the type of operating agreement frequently found especially in "wildcat" oil and gas areas. Persons, like these appellants, who have working interests as lessees or operating rights under lessees get together with a development program. They are usually referred to as "non-operators". Next they find an operator, who will undertake drilling a test well at his sole expense for an interest in the profits out of production. He also agrees to keep the leases alive by payment of rentals or development. In some instances the operator puts up all the costs of developing, producing and equipping wells to be repaid out of production, if any. The non-operators take no risk, but share in a percentage of profits, as was the case here. A common

basis is 75% to the operator and 25% to the non-operators. The operator, being the only one required to put up money, is ordinarily given wide discretion in the development program. As will be shown, this agreement follows the usual pattern.

The Fidelity Operating Agreement provides in part:

The rights of non-operators in specified lands under leases, permits and agreements are committed to the operating agreement. Then it is agreed:

1. Non-operators represent that they own or control as "lessees, permittees or operators" interests of 87½% of all oil and gas. (Ex. 2, Par. 1)
2. Operator agrees to perform the obligations imposed on non-operators under the various leases, permits and agreements. It may after notice surrender or quitclaim the lease, permit or agreement to the non-operator owner. (Par. 2) Near the end is a forfeiture clause which will be considered later.
3. Operator agrees: To "conduct a geological examination of Cedar Creek Anticline, . . . for the purpose of determining a location deemed favorable for drilling a well to test said structure for oil and/or gas."

In the same paragraph the time for commencement of drilling was set at one year after certain agreements were executed on specified lands. The test well was to be located on lands within the "structure"—Cedar Creek Anticline. Its depth and other conditions were specified.

4. If the first test well proved noncommercial Fidelity was given the right to "prosecute further drilling . . . at such times as shall be deemed by it to be good oil field practice, having due regard that the drilling operations hereunder are purely exploratory and speculative." (Par. 4)
5. If oil was discovered in the test well in commercial

quantities, outside a specified area, Fidelity agreed to commence a second test well within Units 2, 3, 4, or 5, to test a horizon where production was found in the first test. (Par. 5) If the second test proved commercially productive, Fidelity was obligated to continue drilling new wells in the productive area "for the purpose of progressively extending the producing limits, toward and upon" the lands subject to the particular contract. (Par. 5)

6. It was also provided that Fidelity "shall be free to exercise its sole discretion and judgment in" performing terms of leases, permits and agreements and in developing, drilling, operating and producing oil from the land. (Par. 6)

Then follow provisions governing costs of operations, division of profits, sale of oil, unitization and many other details not immediately important.

b. **Purpose.**

The Fidelity Operating Agreements, the Gas Unit Agreement and Gas Purchase Agreement were brought into being as "triplets", so to speak, at the Billings meeting with U.S.G.S. officials during May, 1934. The interested parties were faced with these problems: (a) Wight and others who held interests under government leases needed a market for gas in order to pay rentals, compensatory royalties and hold their rights. This immediate problem and a future market for gas was taken care of through the gas purchase agreements. (b) Excessive drilling was avoided and good conservation practices were assured by the Gas Unit Agreement. Also, under it, the burden of initial drilling and operating costs was shifted from Wight, Norbeck and appellants or their predecessors to the operator. (c) Finally, it was desirable for all concerned to have as much land as possible

within Cedar Creek Anticline, blocked up for development of gas and oil if any were found at lower horizons. This was desirable in making the area attractive to those able to risk capital on expensive development, as pointed out in the testimony of witnesses Davies (Tr. 512) and Barnes (Tr. 682). This was accomplished through the Fidelity Operating Agreement.

c. Meaning.

The deep rights were committed to the Fidelity Operating Agreements on about 90% of the lands in Cedar Creek Anticline; not always by the landowner lessors, but by the owners of working interests created by base leases and prospecting permits. Having assured continuation of the leases under the gas units and purchase agreements, they were in position to realize profits through production from deeper horizons, without any expenditure of money by them, under Fidelity Operating Agreements.

The burden of lease and other obligations was transferred to Fidelity. It was also agreed to make geophysical tests of Cedar Creek Anticline to find the most suitable location for a test well. With this done a test well had to be drilled to specified depths at a location anywhere on the structure.

The next consideration to be covered was: "What happened if the test well was a dry hole?" Paragraph 4 gives the answer by providing: "second party shall have the right, at its option, to prosecute such further drilling of wells under like terms and conditions, and at such times as shall be deemed by it good oil field practice, having due regard that the drilling operations hereunder are purely exploratory and speculative." . . . (Par. 4)

Then to cover what must be done if the test well is productive fixed obligations are provided in paragraph 5. If the com-

mercial well is on lands not covered by the specific agreement but within Cedar Creek Anticline, a second well must be commenced on lands in Units 2, 3, 4 or 5, within one year after completion of the commercially productive well. If the second well is commercial Fidelity agrees to "prosecute in accordance with good oil field practice the further drilling of wells in the vicinity of said paying well, or wells, . . . for the purpose of progressively extending the producing limits, toward and upon the lands subject to this agreement."

These provisions are perfectly clear. If commercial production were found in the test well a second test well had to be commenced within a year in a specified area. Even then drilling was not required on lands subject to leases in which appellants were interested; only such drilling as good field practice dictated, progressively extending production toward the lands in the specific agreement if and when there was production.

Naturally, less stringent provisions were to apply where the first test well was a dry hole. Therefore, additional drilling was not required to commence within a year, but *"at such times as shall be deemed by it to be good oil field practice."* The amount of drilling was also to be governed by good oil field practice taking into consideration that such drilling operations "are purely exploratory and speculative," with due regard to weather and road conditions. (Par. 4) Weather and road conditions in the rugged Cedar Creek area make the purpose of this provision obvious as a protection to an operator in his development program.

d. **Performance.**

The appellants do not question the fact that the Fidelity Operating Agreements were regularly executed, geophysical work was done, and the test well was drilled as agreed. It follows, without question, that the agreements went into effect

and remain valid and subsisting agreements unless they have been cancelled or voided in some manner.

The following chronological list of drilling and development carried on by, or on behalf of, Fidelity under the Fidelity Operating Agreement summarizes the previous statement of facts for more ready reference:

1935	N. P. No. 1 commenced. (Tr. 542)
1936	Smith No. 1 commenced. (Tr. 544)
	N. P. No. 1 completed. (Tr. 543)
	Warren well commenced. (Tr. 544)
1937	Smith No. 1 completed. (Tr. 546)
	Warren well completed. (Tr. 545)
1938	Pumping test at Smith well. (Tr. 545)
1939	Negotiations unexpectedly terminated with The California Company. (Tr. 512)
1940	Negotiations began with Carter. (Tr. 551)
1941	Well spudded in May 12, 1941. (Tr. 552)
1942	Well plugged and abandoned. (Tr. 552)
1941 to 1946	World War II in progress. Labor and equipment shortage. (Tr. 556-559)
1947	Negotiations with J. E. Manning and others. (Tr. 559)
1948	Negotiations with Husky Refining Company. (Tr. 560)
1949	Contracted with Husky Refining and well commenced. (Tr. 561) Well completed 1949.
1950	Negotiations began with Shell. (Tr. 562)
1951	Shell Agreement dated April 10, 1951. (Ex. 5)

1952	Shell-Pine Well completed. (Tr. 693, Ex. 60)
	Shell Little Beaver No. 1 completed. (Ex. 60)
1952 to 1955	Continuous drilling of 53 wells by Shell to March 31, 1955. (Ex. 60) (Tr. 693)
1935 to 1955	Gas being produced and purchased from lands of appellants and Units 1 to 8B inclusive under Gas Unit Agreements and Gas Purchase Agreements.

There was a continuous effort to explore the deep horizons of Cedar Creek Anticline for oil. This was the primary objective under the Fidelity Operating Agreements. The development of the specific lands in which appellants and other parties had working interests was secondary. The period 1942 to 1947 was the longest period of non-drilling activity. World War II was then in progress and controls resulting therefrom were continued.

In the recent decision of the supreme court, *Fey v. A. A. Oil Corporation*, ... Mont. ...., 285 P. (2d) 578, 589 (June 1955), forfeiture and cancellation of a lease on 9,000 acres of land, which was part of a structure, was sought. One gas well was drilled on the Fey land from which no gas was marketed. It was contended that the lessee had failed to diligently develop. During a portion of the period World War II was in progress, there was a shortage of labor and materials and no market was available for sale of gas. These comments by the court are applicable here:

> "While there was considerable delay in the completion of Fey No. 1 well, and in the subsequent unsuccessful attempts to drill the second well on the Fey lands by the Feys' refusal to allow defendants entrance to drill, *the further circumstances of the inability of defendants to obtain materials for the drilling was not controverted. During those war years all operators were*

> *restricted by the government's strict allocation of iron and steel products.* The lessees proceeded to develop the properties under all the circumstances with reasonable diligence and in accordance with what a reasonably prudent operator would have done." (Emphasis supplied)

In the face of repeated discouraging results Fidelity continued its development effort until the ultimate purpose of the Fidelity Operating Agreements was accomplished; namely, the discovery and development of oil in the deeper sands of Cedar Creek Anticline.

If the efforts of Fidelity, prior to discovery of oil, were thought inadequate under the agreement an avenue was open to appellants. They could have served notice of default if in fact there was a default and the agreement would have been cancelled, unless the default was remedied within 30 days. (Par. 2) No notice of forfeiture having been given, this exit from the agreement is foreclosed. The difficult and expensive undertaking of oil development from very deep wells in Cedar Creek Anticline was successful under the Fidelity Operating Agreement. If appellants were dissatisfied anywhere along the way, why did they not say so or give notice of default?

At this point it seems appropriate to call attention to the equitable nature of the action. Appellants seek equity, so must they do equity. Was it in equity and good conscience that appellants, on John Wight's advice and with purpose and design, withheld notice of forfeiture after Wight assured them that Fidelity would remedy any default if given the opportunity? (Ex. 20, Tr. 333)

2.

The trial court's conclusions that appellants' claims are barred by the defenses of laches, estoppel and waiver are supported by the facts and the law.

A. The trial court's findings of fact relating to laches, estoppel and waiver are amply supported by the facts.

(1) The Fidelity Operating Agreements covering 90 percent of acreage in Cedar Creek Anticline within Units 1 to 8B, made development possible.

Fidelity Operating Agreements were obtained on about 90 percent of the acreage on the Cedar Creek Anticline, from Unit 1 to and including Units 8A and 8B. (Tr. 539) The geographical extent of the Cedar Creek Anticline is not questioned by appellants. A two-section map showing this data and the location of Units 1 through 8B is in evidence without objection. (Ex. 1, 1A, Tr. 230) Witness DeWolff classified the Anticline as one geologic structure. (Tr. 490) The Fidelity Operating Agreement under its own terms contemplates cooperative exploration and development on the *entire* Anticline. (Ex. 2, Par. 3, 5) The Carter Oil Company agreements in 1940 (Ex. 43, 44) and the Husky Refining Company agreements in 1948 (Ex. 46, 47) with Fidelity covered operations pursuant to the Fidelity Operating Agreement.

The Shell-Fidelity Operating Agreement of April 10, 1951 (Ex. 5) expressly covers *all* of the Fidelity Operating Agreements, *i.e.* covering about 90% of the acreage on the Anticline. A reading of the opening paragraphs of the Shell agreement reflects that it contemplates operations on the *entire* Anticline. It does not, as grossly misstated by appellants "relate primarily to Units 8A and 8B." (Brief 31)

The foregoing resume reflects that Fidelity, initially, Carter, Husky and Shell all sought, and to a large extent obtained, essential control of Anticline lands before undertaking expensive exploratory operations. The California Company, in its unsuccessful negotiations with Fidelity were "interested in taking over interests on the entire anticline." (Tr. 512) The testimony of appellees' witnesses Davies (Tr. 512) and Barnes (Tr. 682) points out that control of the block of land is a prerequisite to expensive exploration. It is a perversion of Barnes' testimony to hint, as did appellants, that the saving of time is the only consideration. (Brief 30)

(2) Heavy expenditures under the Fidelity Operating Agreement.

The significance of heavy expenditures, particularly when made with knowledge of appellants, will be covered in the discussion applying the equitable defenses to the facts now being outlined.

The development of the deep sands under the Fidelity Operating Agreement has been detailed on pages 17 and 18 herein. The principal expenditures were as follows: early geophysical work costing about $25,000 (Tr. 542); N. P. No. 1 Well, $212,251.00; the Warren Well, $88,063.03; and the Smith, $125,615.88 (Tr. 543, 545, 547); Husky's well in 1949 cost $165,964.32 (Tr. 562).

Evidence as to the cost of the Carter well was not admitted. (Tr. 555) However, it was drilled to a depth of 9,100 or 9,200 feet, and it is evident that a considerable sum was expended. (Tr. 552)

Shell spent $725,000 for seismic and geophysical work on the Anticline in 1950, 1951 and 1952; $600,000 during 1953 and 1954. (Tr. 681) Appellants assert that the witness Barnes did not say that any of this was spent on appellants' lands or

in Unit 5. (Brief 37) This assertion flies directly in the face of the record. Witness Barnes testified "we . . . then came back up along the anticline with various other lines across the structure, one of which was tied into the Warren well." (Tr. 663) The Warren well was located in Unit 5. (Tr. 489) Specifically, Barnes testified further:

"Q. Did you also run a survey or a line in Unit 5?

A. We did; there have been a number of them in that unit." (Tr. 664)

Shell drilled or commenced eleven wells before the summons was served at a cost of $1,846,180.00. Thereafter up until March 31, 1955, 42 additional wells cost $9,335,497.00. There were additional expenditures in the field of $732,999.00, making in all a total of $11,914,676.00. (Ex. 60)

(3) Value of oil and gas interests on Anticline have been greatly enhanced.

Again, the fluctuating character of oil and mining properties is one of, if not the most important element to be considered in applying the equitable defenses. The courts have rigorously applied the doctrine of laches, estoppel and waiver in this case, as appellees shall later point out.

Shell discovered oil in the Pine Area of the Cedar Creek Anticline in October 1951 (Tr. 669) and in Little Beaver, at the south end of the Anticline, in July 1952. (Ex. 60) Values of acreage in the Cedar Creek Anticline suddenly spiralled. Prior to Shell's Pine and Little Beaver, drilled pursuant to the Shell-Fidelity Operating Agreement of April 10, 1951, leases had a value of $2.50 per acre and subsequently went as high as $430.00 an acre and an average of between $300.00 and $500.00 per acre. (Tr. 653) In fact, during 1950 there was considerable Federal acreage on or adjacent to the Anticline

that could be leased for simply the filing fee of 50 cents per acre. (Tr. 645)

As mentioned earlier, even witness Jirik, President of appellant Cedar Creek Oil and Gas Company, testified:

"Q. Has the drilling of the well by Shell in Little Beaver created any new interest?

A. I am happy to tell you it is just a completely new picture with the Shell people doing what they are doing.

Q. It puts an entirely different complexion on the whole Cedar Creek Anticline, doesn't it?

A. Absolutely. (Tr. 431, 432)

. . . . .

Q. Now, did you also learn of the Shell discovery in the Pine Unit in the Cedar Creek Anticline in January, 1952?

A. Yes, sir.

Q. And would you also say that helped to put a new complexion on the whole Cedar Creek Anticline possibilties for oil production?

A. Yes, sir, it did." (Tr. 433)

There is no question about the huge increase in value stemming from Shell's discoveries.

(4) Appellants knew that appellees were continuing to claim under the Fidelity Operating Agreements.

The record is clear, and it was so stipulated that appellees Montana-Dakota Utilities and Fidelity Gas Company advised each appellant by letter dated April 27, 1951 of the Shell-Fidelity Operating Agreement of April 10, 1951. (Ex. 26, Tr. 374) In that notice, each appellant was expressly advised that all lands

on which Fidelity held operating agreements had been committed to the Shell agreement.

Further, the letter said Shell had agreed to commence a deep test well within 90 days.

As a result the district court found that appellants knew "*at least,* from shortly after April 27, 1951" that appellees were claiming under the Fidelity Operating Agreements and that appellee Shell was preparing to spend large sums in reliance upon these agreements. (Finding XXIII, Tr. 196, 197) The words "at least" are significant. There is substantial evidence to warrant a finding that appellants knew in 1949 of Fidelity's continued claim under the Fidelity Operating Agreement and some evidence that they knew much earlier.

We turn first to knowledge in 1949. The testimony of appellants' leading and interested witness, John Wight, is replete with references to him acting in a representative capacity for appellants, naming them several times as "my group". (Tr. 245, 249, 278, 282, 325, 354) He had long and extensive experience in oil and gas dealings in the Cedar Creek Anticline. (Tr. 238-242; 319-321) In 1949 Wight prepared and sent to each of the appellants a form of notice which, in turn, was to be sent to appellees, Fidelity and Montana-Dakota, advising them that the Fidelity Operating Agreements were no longer valid. (Ex. 21, Tr. 332) This precipitated a question to Wight as to whether in 1949 he "thought Fidelity might be claiming some interest under this agreement." He answered: "I knew if there was any chance of Fidelity or Montana-Dakota Utilities thinking they could claim it, they would do it." He continued:

> "A. I hadn't heard that they had, but I knew enough about them. I knew they would if they could. I didn't intend to let them claim anything they didn't have

a right to claim. I wanted to close the door before they made a claim.

Q. That was in 1949?

A. I knew them well enough to know they would grab on to anything. As soon as Amerada discovered oil in North Dakota, I knew if there was any chance, they would be in to claim.

Q. Was it 1949 that Amerada discovered oil in North Dakota? I will give you the date of May, 1951. Was that the first discovery made by Amerada in North Dakota?

A. They started drilling in 1949.

Q. So, in 1949, then you thought Fidelity might be claiming some interest under this agreement?

A. As soon as it rather looked like it was becoming valuable, as soon as Amerada was going to drill, I knew if there was any chance of Fidelity or Montana-Dakota Utilities thinking they could claim it, they would do it. I thought I could forestall any claim they might put out. I didn't think they had a legal claim or right. I didn't know what a Court would decide. I thought they were out, defaulted, abandoned it." (Tr. 336)

(It is noteworthy that Fidelity had late in 1948 negotiated the agreements with Husky Refining under which the Husky well was drilled in 1949.) (Ex. 46, 47)

The record also shows, with respect to knowledge on the part of appellant Cedar Creek, that Mr. Jirik, president, discussed the drilling of the Carter and Husky wells frequently with Mr. Cecil Smith of Montana-Dakota and Fidelity, although Jirik denied this as to the Husky well. (Tr. 572, 700)

(5) Steps taken by appellants to assert their claims.

Although this suit was filed in state court in December, 1952, Shell was not joined as a defendant nor were any of the parties served until the amended complaint was filed on February 2, 1953. Therefore appellees take the date of February 2, 1953 as the date upon which appellants instituted action. This is the date found by the district court (Tr. 197) and used by appellants. (Brief 54)

There is no evidence in the record of any written notice to Shell advising of appellants' claims. Appellants gave Fidelity and Montana-Dakota no written notice pertaining to the Fidelity Operating Agreement other than a letter dated September 12, 1952 from Cedar Creek (Ex. 21) and a letter dated July 16, 1951 from H. C. Smith (Ex. 30) declaring forfeited and cancelled any interests under the old operating agreements. The Smith letter was termed by the district court "ineffective as a notice of default" under paragraph 2 of the Fidelity Operating Agreement. (Tr. 180)

Appellants completely disregard the record when they twice say that Susan Wight sent a notice cancelling the Fidelity Operating Agreement. (Brief 39, 52) Exhibit 15 only purports to cancel *paragraph 8 of the Gas Unit Agreement*. It had nothing to do with the Fidelity Operating Agreement.

No notice of default was ever given appellees by any of the appellants. (Tr. 572)

In a final effort to show notice to Shell of appellants' claim, resort is had to some alleged conversations between Wight and a Shell representative or representatives. Appellees find it impossible to determine when or how many times these alleged conversations took place or just who participated. (Tr. 276, 277, 295-297, 300, 301, 304-307, 328, 329) This, in our opinion,

is a classic example of confusion in testimony. It demonstrates a sound basis for the regard given to the opportunity of the trial court to gauge the credibility of the witnesses, under Rule 52(a) of the Rules of Civil Procedure. The trial court, as it had a right to do, disregarded this testimony. It found that appellants "remained silent and made no claim that the Fidelity Operating Agreements had expired . . ." (Finding XXIII, Tr. 197) Presumably this includes Wight acting in their behalf. The trial court affirmatively found that early in 1950 Shell began its negotiations with the other appellees, resulting in the April 10, 1951 operating agreement. (Finding XX)

(6) Proximity of drilling to appellants' leases.

Appellees cannot see how the distance of wells drilled from appellants' leases have any bearing on the equitable defenses. Such references are made in appellants' brief, in an apparent effort to create a special class of Fidelity Operating Agreements as applied to Unit 5. In the same vein they repeatedly refer to "Fidelity Agreements as they applied to appellants' land".

It should be quite apparent from the wells platted on Ex. 1 and 1A and the tabulation of wells drilled (Ex. 60) that Shell is "drilling new wells for the purpose of progressively extending the producing limits, toward and upon" the leases of appellants as required by paragraph 5 of the Fidelity Operating Agreement. Shell's offered testimony regarding its plans for drilling in Unit 5 was rejected. (Tr. 680)

Appellants frequently refer to Shell's drilling as not "within 12 miles of appellants' land"; and "many miles remote" (Brief 15); "far distant" (Brief 37); "nor within 12 miles" (Brief 47). These statements are not supported by the evidence. Exhibits 1 and 1A show Shell-N. P. Well No. 41-4 in the extreme

south of Unit 3 about 6 miles northerly of the appellants' most northerly leases.

B. Established principles of law support the court's conclusions of law sustaining these defenses.

1. LACHES

(1) Application of laches generally.

The question of laches is addressed to the sound discretion of the trial court, and its decision will not be disturbed on appeal unless it is so clearly wrong as to amount to an abuse of discretion.

> *Gillons v. Shell Co. of California*
> 86 F. 2d 600 (9th Cir. 1936) Cert. denied
> 302 U.S. 689, 58 S. Ct. 9, 82 L. Ed. 532;
>
> *Kimberly Corp. v. Hartley Pen Co.*
> 237 F. 2d 294 (9th Cir. 1956);
>
> *Robert Hind, Ltd. v. Silva*
> 75 F. 2d 74 (9th Cir. 1935);
>
> *Pacific Royalty Co. v. Williams*
> 227 F. 2d 49 (1955), cert. denied 351 U.S.
> 951, 100 L. Ed. 1474.

Potash Co. of America v. International Min. & C. Corp., 213 F. 2d 153, 154, (10th Cir. 1954), tersely comments:

> "To constitute laches two elements must exist: first, inexcusable delay in instituting suit and second, prejudice resulting to the defendant from such delay."

Hammond v. Hopkins, 143 U. S. 224, 12 S. Ct. 418, 427, 36 L. Ed. 134 (1892), outlined the basis for the well-established principle thus:

> "Each case must necessarily be governed by its own circumstances, since, though the lapse of a few years may be sufficient to defeat the action in one case, a longer period may be held requisite in another, dependent upon the situation of the parties, the extent of their knowledge or means of information, great changes in values, ..."

(2) The doctrine of laches is relentlessly applied in cases involving oil and mining properties.

Appellants have carefully sidestepped any reference to the wealth of decisions concerning the vigorous application of laches to oil and mining properties.

The general rule is well stated as follows:

> "A person may not withhold his claim, awaiting the outcome of an enterprise, and then, after a decided turn has taken place in his favor, assert his interest, especially where he has thus avoided the risks of the enterprise. Accordingly, if the property involved is of a speculative or fluctuating character, more than ordinary promptness is required of the claimant; he must press his claim at the earliest possible time. *This rule is applied with great strictness in the case of oil or mining property, since it is of a specially precarious nature, and is exposed to the utmost fluctuations in value.*" (30 C.J.S., Equity, § 118, p. 541) Emphasis supplied)

The landmark case in the field is *Twin-Lick Oil Co. v. Marbury,* 91 U.S. 587, 593, 23 L. Ed. 328 (1875). The defendant Marbury had loaned money to plaintiff corporation, of which he was a director and stockholder. As security for repayment of the loan, he took the corporation's deed of trust covering, among other properties, a producing oil and gas lease. Four years after the foreclosure and defendant's acquisition of title, plaintiff brought the action to impose a constructive trust and have the sale set aside on the ground of fraud. After holding there was no evidence of fraud and the transaction was not void, the court concluding that the plaintiff was guilty of laches, said:

> "The fluctuating character and value of this class of property is remarkably illustrated in the history of the production of mineral oil from wells. Property worth thousands today is worth nothing tomorrow; and that which would today sell for a thousand dollars as its fair

> value, may, by the natural changes of a week or the energy and courage of desperate enterprise, in the same time be made to yield that much every day. The injustice, therefore, is obvious of permitting one holding the right to assert an ownership in such property to voluntarily await the event, and then decide, when the danger which is over has been at the risk of another, to come in and share the profit."

This forceful statement has been quoted many times, among them being:

Johnston v. Standard Min. Co.
148 U.S. 360, 13 S. Ct. 585, 37 L. Ed. 480 (1893);

Haynes v. Silver Prince Min. Co.
86 Mont. 10, 281 Pac. 548 (1929);

Mantle v. Speculator Min. Co.
27 Mont. 473, 71 Pac. 665, 667 (1903);

Medallion Oil Co. v. Hinckley
92 F. 2d 155, (9th Cir. 1937);

Buchler v. Black
226 F. 703, (9th Cir. 1915);

Taylor v. Salt Creek Consol. Oil Co.
285 F. 532, 539, (8th Cir. 1922).

The Supreme Court has spoken with equal emphasis as to mining properties, in *Patterson v. Hewitt,* 195 U.S. 309, 321, 25 S. Ct. 35, 49 L. Ed. 214 (1904):

> "There is no class of property more subject to sudden and violent fluctuations of value than mining lands. A location which today may have no salable value may in a month become worth its millions . . . Under such circumstances, persons having claims to such property are bound to the utmost diligence in enforcing them, and there is no class of cases in which the doctrine of laches has been more relentlessly enforced."

"Sitting by idly" was condemned strongly in *Corey v. Sunburst Oil & Gas Co.,* 72 Mont. 383, 397, 399, 233 Pac. 909, 911, 912 (1923), cert. den. 268 U.S. 98, 45 S. Ct. 420, 69 L.

Ed. 865. There the timetable reflected an oil and gas lease dated May 29, 1920, on land then having little or no speculative sale for oil or gas rights; the discovery of oil in the same township on June 5, 1922, and suit started by the plaintiff landowner in May 1923 to declare the lease void. In 1920 the lessee-operator leased 50,000 acres or more in the supposed limits of the Rocky Ridge Dome, in order to warrant the expense of testing the dome. Relying on these leases, including the one in question, approximately $25,000 was spent in exploring the area leading up to the June 1922 discovery.

Plaintiff claimed the lease was void as contravening the policy of Congress because he gave the lease before making final proof on his patent, and also that it violated a Montana statute. He urged that estoppel may not be predicated on a void instrument.

Considering that the validity of the lease was doubtful, the court twice hit at the inequity of plaintiff's position in sitting by idly:

> ". . . Whether the land was valuable for oil or gas purposes was purely speculative. The plaintiff obtains patent, and then sits by observing the defendant's predecessor in interest spend huge sums of money in exploiting the field; oil is found in paying quantities in the vicinity of his land; his land becomes of great value by reason of the foregoing facts; almost a year after the oil is found he begins this suit; . . ."
>
> ". . . Having been, according to his own theory, a party to an illegal contract, he now seeks to avail himself of that illegality to his own advantage and to the disadvantage of the other party. Having sat by while another expended toil and money in bringing forth riches, he would take the riches and leave the other nothing."

Several other cases in Montana warrant special mention in this field.

The first, *Hynes v. Silver Prince Mining Co.*, 86 Mont. 10,

18, 281 P. 548, 551 (1929) involved an action brought late in 1926 to quiet title to an undivided one-third interest in a mining claim, based on a contract of February 23, 1880. Mining activity in the area was at a "practical standstill" from 1880 until 1916 or 1917. Since then, defendants had been developing the property, expended over $250,000, and at the time of trial the property was being operated at a profit. Holding it would be inequitable to allow plaintiff to recover the court said:

> "Plaintiff has slept upon his rights, if any he ever had. His application is destitute of conscience, good faith, and reasonable diligence. It would be highly inequitable to permit him now, after defendants' enterprise and energy and the expenditure of enormous sums of money have developed the property and greatly increased its value, when the danger, which is over, was at defendants' risk, to assert ownership to an interest in the property and share in the profits."

To the same effect see: *O'Hanlon v. Ruby Gulch Mining Co.*, 64 Mont. 318, 328-330, 209 P. 1062 (1922).

The following decisions from other jurisdictions are to the same effect.

In *Hunt v. Pick*, 240 F. 2d 782, 786, (10th Cir. 1957), plaintiffs on June 7, 1955, sued for an accounting under an alleged oral mining partnership agreement made in 1952 covering uranium claims. Plaintiffs ceased working on the claims in September 1952, and were paid wages and other items of expense. The claims became a spectacular success.

In discussing the merits of plaintiff's claim, the court said:

> "Nowhere in the law has the doctrine of laches been more strictly applied ,and properly so, than in controversies involving mining claims. . . . And so, in applying the doctrine of laches, the emphasis is less upon the passage of time and more upon the effort expended and the risk taken for here, too, the reward should be preserved to him, who having discovered, proceeds to develop."

Also see:

Mason v. MacFadden
298 F. 384, (8th Cir. 1924);

Preston v. Kaw Pipe Line Co.
113 F. 2d 311, (10th Cir. 1940);

Winn v. Shugart
112 F. 2d 617, (10th Cir. 1940);

Swartz v. Dennis
208 Okl. 344, 255 P. 2d 923 (1952);

Murphy v. Johnson
54 S.W. 2d 158, (Tex. Civ. App. 1932);

Union Oil & Gas Co. v. Cross
220 Ky. 271, 295 S.W. 172, (1926)

Walker-Lucas-Hudson Oil Co. v. Hudson
168 Ark. 1098, 272 S.W. 836 (1925)

(3) In oil and mining cases, laches has been found although the period of time is relatively short.

Short periods of delay, accompanied by other circumstances, may constitute laches. This is reflected in *Patterson v. Hewitt*, 195 U.S. 309, 25 S. Ct. 35, 37, 49 L. Ed. 214 (1904), where it was said:

> "Indeed, in some cases the diligence required is measured by months rather than by years. . . . And in others a delay of two, three, or four years has been held fatal."

The foregoing excerpt was quoted by this Court in *Buchler v. Black*, 226 F. 703, at page 707, in which other cases involving short periods were reviewed.

A delay of 19 months in seeking rescission of the mining lease transaction constituted laches in *DeLamar Mines of Montana v. Mackay*, 104 F. 2d 271, (9th Cir. 1939).

United Fuel Gas Co. v. Cabot, 96 W. Va. 387, 122 S.E. 922 (1924), involved a very short period.

Parker v. Ryan, 143 Okl. 187, 287 P. 1006 (1930), was a suit for specific performance. Plaintiff was entitled to receive an interest in oil lands upon termination of certain litigation but waited about seven months before demanding performance. Shortly after a prolific oil well was completed on neighboring land. The court found him guilty of laches and denied relief.

Laches was sustained where 18 months elapsed between discovery of the facts and the action for rescission, oil having been discovered on the land in the meantime. *Brown v. Privette,* 109 Okl. 1, 234 P. 577 (1925).

Eighteen months' delay in bringing suit to cancel a royalty conveyance after learning of the alleged fraud barred plaintiff by his laches in *Davis v. Godwin-Barclay Co.,* 120 Okl. 274, 251 P. 1042 (1926). It appears from the opinion that oil value of the land had increased during this period.

(4) Doctrine of laches as analogous to statute of limitations.

Appellants assert that courts apply the applicable statute of limitations in measuring the time required to support laches "except in the most unusual cases". Appellees assume that the unusual cases to which they refer are the oil and mining cases which appellees have covered and which appellants have carefully avoided.

As so aptly stated by this Court in *Gillons v. Shell Co. of Cal.,* 86 F. 2d 600, 610, (1936):

> "In connection with the bar of laches, from the earliest days federal courts have emphasized the distinction between a reasonable and an unreasonable delay in bringing suit . . . even *within* the period designated by the statute of limitations."

A suit in equity may fail though not barred by the act of limitations. *Holmberg v. Armbrecht,* 327 U.S. 392, 396, 66 S. Ct. 582, 584, 90 L. Ed. 743, (1946).

(5) Effect of July 16, 1951 "cancellation notice" from appellant H. C. Smith and September 29, 1952 letter from appellant Cedar Creek to appellees, Fidelity Gas and Montana-Dakota.

It is clear that the July 16, 1951 letter (Ex. 30) from H. C. Smith and the September 29, 1952 letter (Ex. 37) from Cedar Creek were, at the most, mere assertions of a claim. There is ample authority that the mere assertion of a claim, with nothing more, will not defeat laches. In *Penn Mutual Life Ins. Co. v. City of Austin*, 168 U.S. 685, 18 S. Ct. 223, 228, 42 L. Ed. 626 (1898), the court referred to this doctrine as an elementary principle.

The trial court had before it all the evidence and an opportunity to judge the credibility of witnesses. The trial court properly expressed its discretion in sustaining the defense of laches, since it appears that:

(a) The appellants sat by and did nothing from 1949 or earlier, or at least from April 27, 1951 until suit was filed February 2, 1953, with full knowledge of appellees' claims under the Fidelity Operating Agreement;

(b) Tremendous expenditures were made by appellees during this period pursuant to the Fidelity Operating Agreements;

(c) The values of oil and gas interests on the Cedar Creek Anticline, including appellants' lease, were greatly enhanced during this period as a result of appellees' work pursuant to the Fidelity Operating Agreement.

These factual elements have carried great weight in the decisions heretofore discussed. It is clear that appellants did not "press their claim" at the earliest possible time. *30 C.J.S. Equity, § 118, p. 541.* It is equally clear that appellees have been prejudiced by the delay and stand to lose not only the greatly increased value of their rights in appellants' leases under the

Fidelity Operating Agreement but, by force of an adverse decision, their identical rights in other lands on the Cedar Creek Anticline will be jeopardized.

2. ESTOPPEL

(1) Application of estoppel generally.

The tendency to blend the terms "laches" and "estoppel" is noted in 19 Am. Jur., Equity, § 493, p. 341:

> "References are found in the reports to 'the doctrine of estoppel by laches' (citing Northern P. R. Co. v. Boyd, 228 U.S. 482, 33 S. Ct. 554, 57 L. Ed. 931), and to the fact that by reason of laches a complainant is 'barred and estopped' from maintaining a suit."

The distinction is pointed out in 19 Am. Jur., Estoppel, § 38, p. 637, where it is observed:

> "The doctrines of laches and estoppel are closely related especially where, as is the case in most jurisdictions, delay alone is not regarded as constituting laches, but only delay which places another at a disadvantage. Laches is sometimes spoken of as a species of estoppel and is often an element in estoppel. Clearly, however, the terms are not synonymous since laches is a doctrine peculiar to courts of equity while the doctrine of estoppel is applied as readily at law as in equity. Moreover, laches is a wholly negative thing so far as concerns the party against which it is asserted, while estoppel may involve affirmative action on his part."

This court noted this distinction in even clearer terms in *Gillons v. Shell Co. of California,* 86 F. 2d 600, 607 (9th Cir. 1936).

The distinctly different defense of estoppel is treated at great length by appellants, almost to the exclusion of "laches" and "waiver". (Brief 19-49)

Woven throughout this portion of their brief are assertions of fact which fight, not only the inferences which the trial court rightly made, but the facts reflected by the record.

After a review of the general legal principles on estoppel,

appellants seek to knock out the trial court's findings as to certain elements of estoppel.

(2) Finding of reliance by Shell on the Fidelity Operating Agreement is supported by evidence.

It is said there is no proof that Shell relied upon the Fidelity Operating Agreements in entering into its April 10, 1951 operating agreement with Fidelity and Montana-Dakota. Complaint is made of appellees' failure to call as witnesses "officers of the defendant Shell who negotiated the agreement". (Brief, 29) The argument boils down to a contention that there must be express, self serving declaration testimony that "we relied upon the Fidelity Operating Agreement" in order to support the trial court's finding of reliance. (Findings XXIII, XXV, Tr. 196, 197) This argument ignores the well established principle that an inference can be drawn from the facts proven. Had appellants continued with the excerpt from 31 C.J.S. Etoppel § 162, p. 458, at page 26 of their brief, there would be added:

> ". . . However, reliance on the representations of another need not be proved by direct evidence, but may be inferred from circumstances. The intention that another should act on a representation or concealment may also be inferred from circumstances."

The rule that the decision of any issue in a civil case may rest entirely on circumstantial evidence has been consistently followed in Montana and recognized by this Court.

Doney v. Ellison
103 Mont. 591, 64 P. 2d 348, 350 (1937);

Fegles Construction Co. v.
McLaughlin Construction Co.
205 F. 2d 637 (9th Cir. 1953).

Illustrative of the many applications of the principle to "reliance" in estoppel cases is *Ste. Marie v. Wells*, 93 Vt. 398, 108 A. 270 (1919) stating:

> "The plaintiff did not testify in terms that he acted in reliance upon defendant's representations in the purchase of the farm. But there is ample authority for the proposition that the fact of reliance need not be proved by direct evidence, but may be inferred from the circumstances . . ."

Appellants' contention that the court erred in finding estoppel is based on the false premise, that there was no evidence appellees relied on the Fidelity Operating Agreements, since their officers and agents were not called to say in so many words: "Yes, we relied on the agreements." Appellants fail to give any weight to circumstantial and indirect evidence and the deductions and inferences which must be made from established facts.

Uncontradicted evidence first established the Cedar Creek Anticline as one structure. (Tr. 490) The Fidelity Operating Agreements covered 90 percent of the acreage from Unit 1 to and including Units 8A and 8B. (Tr. 539) The very inception indicates that Fidelity did not propose to undertake a test well without having signed agreements on most of the Anticline. Carter, Husky and Shell made sure they had essential control of Anticline lands before undertaking expensive drilling and development. California was interested in taking over interests on the entire Anticline. (Tr. 512) The testimony of Barnes (Tr. 682) and Davies (Tr. 512) points out the desirability of controlling a block of acreage within a structure to be explored. The control of acreage on a structure as a prerequisite to wildcat drilling is so well known to the public and the industry as to be classed as common knowledge of which courts take judicial notice. Before actual discovery and subsequent exploration no one could with certainty say whether appellants' acreage or some other area would prove productive. As compensation for large expenditures in wildcat drilling, agreements covering what was felt might be productive areas were obtained. If each signer

to a Fidelity Operating Agreement could have it cancelled because a Shell official did not testify about reliance on that particular agreement, so could each of the other signers and there would be nothing left. Shell, like Fidelity, California, Carter and Husky, were relying on the overall development rights on the whole anticline. The appellants' argument that there was no showing of any reliance on the agreements covering appellants' acreage, is to say that it would not matter if substantial acreage is taken from the approximate center of a long, narrow structure or anticline in which Professor DeWolf testified: "You may find oil, in my opinion, in various places on that structure now, rather than to expect it all to migrate up to the high end of the structure." (p. 491)

Common sense dictates that Shell did not undertake the expensive drilling program unless it had effective control of the Anticline. The Shell Operating Agreement did not "relate primarily to Units 8A and 8B of the Cedar Creek Anticline" as stated by appellants (Brief, 31) but covered Units 1 through 8B. (Ex. 5, p. 1)

Appellants' distorted version of the trial court findings should be corrected. The court found reliance on the fact that the Fidelity Operating Agreements covering appellants' interests, *and other similar interests on the Cedar Creek Anticline* were valid (Finding XXV, Tr. 197) and not, as appellants state: "that all of Shell's activities were in reliance on the validity of the Fidelity Agreements as they affected appellants' lands." (Brief, 32)

Next, appellants assert a novel but nebulous theory regarding the trial court's findings on Shell's expenditures. They say, as appellees understand it, that Shell risked nothing because, under the Fidelity Operating Agreement, it is entitled to reimbursement before appellees receive their 25% net proceeds. This is, indeed, putting the cart before the horse. The risk comes first,

the hoped for rewards later. (Brief, 35-36)

(3) Shell had no knowledge of appellants' claims nor reason to believe such claims existed.

Appellants argue that Shell knew or should have known of their claim. (Brief, 48)

To show actual knowledge by Shell they rely on:

1. A notice of cancellation from appellant, Susan Wight (Ex. 15) sent "some time in 1950". (Brief, 39)
2. Alleged conversations with a Shell representative or representatives. (Brief 39, 40)
3. A letter dated July 16, 1951 from appellant, H. C. Smith. (Brief, 41)
4. A letter dated September 12, 1952, from Cedar Creek.

Each can be dealt with summarily.

The Susan Wight notice (Ex. 15) has nothing to do with the Fidelity Operating Agreement. It simply purports to cancel paragraph 3 of a gas unit agreement and was directed only to Montana-Dakota.

The H. C. Smith letter (Ex. 30) was not sent to Shell; only to appellees Fidelity and Montana-Dakota. Out of thin air appellants say Shell "knew of it at the time it was received." (Brief, 41) The trial court noted that Smith's letter "does hereby declare forfeited and cancelled any unit or option" claimed by Fidelity or Montana-Dakota under the old operating agreements, and pointed out its ineffectiveness as a notice of default under paragraph 2 of the Fidelity Operating Agreement. (Tr. 180)

The letter of September 12, 1952 (Ex. 37) from appellant Cedar Creek was not sent to Shell: only to appellees Fidelity and Montana-Dakota and then only, as the trial court put it,

"over a year after Cedar Creek, through Mr. Jirik, had learned of the Shell agreement, and by the time of that letter a number of successful wells had been completed by Shell and the lands and leases of the plaintiffs had been greatly enhanced in value." (Tr. 180)

Appellants then go on to say, in effect, that, absent actual knowledge, Shell should have known of appellants' claims. They contend that the language of the Fidelity Operating Agreement coupled with Shell's knowledge of operations under it placed Shell under a duty to inquire of appellants as to any claims they might have. (Brief, 42-45) The trial court, viewing all evidence, found otherwise. In doing so, it probably gave weight to the fact that appellants never notified Fidelity or Montana-Dakota of their claims, prior to the making of the Shell Operating Agreement of April 10, 1951. It no doubt gave weight to the fact that neither appellants nor their leader, John Wight, ever asked Fidelity for a release of the Fidelity Operating Agreements; the net result they are seeking in this action. (Tr. 572, 683)

Shell's conviction and belief that operations under the Fidelity Operating Agreements had been adequately carried out is strongly supported by the fact that it undertook under the Shell Operating Agreement, expensive obligations. It is evident that Shell knew of the costly dry hole just completed by Husky Refining under the Fidelity Operating Agreement and the previous operations under the agreement; and the purely wildcat nature of the area, its remoteness from markets, the high cost of drilling, and the extensive preliminary geophysical work involved.

The trial court, by necessary implication, correctly concluded that it was not incumbent on Shell to search out each "First Party" under each Fidelity Operating Agreement to ascertain whether anyone was claiming termination. Was it necessary for

Shell to seek out specifically the appellants who, as they say, have but 3% of the acreage held by Shell under its Operating Agreement? Would it have been sufficient had Shell contacted only the holders of the other 97% of the acreage? These questions can be resolved only by concluding, as did the trial court, that no such duty existed in these circumstances.

(4) The appellants were silent when they had a duty to speak, at least after April 27, 1951.

Appellees have shown, at pages 23-26, supra, that appellants knew Fidelity was continuing to claim its rights under the Fidelity Agreement in 1949.

The letters of April 27, 1951 (Ex. 26) expressly advised each appellant that all Fidelity agreements had been committed to the Shell agreement and Shell was to commence a deep test well within 90 days on the Anticline. There can be no doubt that each appellant then knew Shell intended to make huge outlays on the strength of the Fidelity agreements. Then, if ever, arose a duty to speak, yet appellants remained silent.

Appellants cite and discuss *Bowes v. Republic Oil Company*, 78 Mont. 134, 252 P. 800 (1927) as authority for the position that appellants were required to do nothing under the foregoing situation. (Brief, 48, 49)

In the *Bowes case* the lease provided that unless a test well was commenced and drilling prosecuted with due diligence on plaintiff's land or within a radius of 3 miles by July 1, 1921, the lease would be null and void. Defendant-lessee failed to meet this deadline, but did, in 1923, do some drilling within the 3-mile radius which was in progress at the time of trial. Such drilling, off the land of plaintiff was held not to estop him from asserting forfeiture.

The *Bowes case* is distinguishable in an important respect.

In the *Bowes* the lease was dead. No one contended that the lessee had prosecuted drilling operations with due diligence as required to keep the lease alive under its express terms. Here Fidelity did the exploratory work and drilled the initial test well required under the Fidelity Operating Agreement.

Here, too, the equities lie much stronger in favor of appellees. The application of equitable estoppel is not governed by mechanical rules. In *Lindblom v. Employers' Liability Assur. Corp.*, 88 Mont. 488, 295 P. 1007, 1009 (1930) the court quoted with approval the following from 10 R.C.L. 689:

> "Equitable estoppels operate as effectually as technical estoppels. They cannot in the nature of things be subjected to fixed and settled rules of universal application, like legal estoppels, nor hampered by the narrow confines of technical formula. So, while the attempted definitions of such an estoppel are numerous, few of them can be considered satisfactory, for the reason that an equitable estoppel rests largely on the facts and circumstances of the particular case."

Appellants pose the question as to what would happen if they had immediately notified appellants of their claim upon the receipt of the letter of April 27, 1951. (Brief, 47) This is pure speculation in which there is no need to indulge.

3. WAIVER

Waiver may be predicated on neglect and failing to act, as to induce a belief that it is the intention and purpose to waive. *Northwestern F & M Ins. Co. v. Pollard*, 74 Mont. 142, 238 P. 594 (1925).

The evidence referred to in the argument on laches and estoppel supports the defense of waiver. The trial court was warranted in concluding that appellants' neglect and failure to act, amounted to an intention to waive their claims that the Fidelity Operating Agreement had terminated.

3.

Under the provisions of paragraphs 4 and 6 of the Fidelity Operating Agreement, appellees were permitted to exercise their discretion as to the extent of further drilling, provided they acted in good faith.

Under paragraph 4 of the Fidelity Operating Agreement, after drilling an uncommercial test well, further development was left to Fidelity's judgment, ". . . as shall be deemed by it to be good oil field practice . . ." Similar provisions in oil and gas leases have been considered by the courts. From their decisions there has been established the rule aptly stated by Professor Summers in his work as follows:

> "Where, however, the lessor expressly agrees that development shall be at the *discretion of the lessee*, a covenant of reasonable development will not be implied and *the standard of performance is the good faith judgment of the lessee.*" (Emphasis supplied) (2 Summers, Oil and Gas, § 398, p. 143, 1956 pocket part)

It is significant that in paragraph 4, dealing with development after completing an uncommercial test well, further drilling was to be at such times "as *shall be deemed by it* to be good oil field practice"; but in paragraph 5, having to do with further drilling after discovery of oil in paying quantities, further drilling must be in accordance "with good oil field practice". Note the omission of the words; "as shall be deemed by it". This is indicative of the mutual intention to give a wide discretion to Fidelity until its exploratory operations were successful and then require drilling in accordance with a fixed standard, "good oil field practice", and not what Fidelity "deemed" good oil field practice. Additional evidence of the intention to allow a wide exercise of discretion and judgment, except where otherwise specifically provided, is found in paragraph 6 as follows:

> "Except as otherwise herein specifically provided,

> second party shall be free to exercise its sole discretion and judgment in the performance of the terms of said leases, permits and agreements, in the developments of said lands, in the location, drilling, operation and production of all wells, and the sale, handling, disposition, treatment of and contracting in respect to all substances produced by it from said lands herein described."

Cases specifically considering similar provisions of oil and gas leases uniformly apply the rule announced by Professor Summers, supra.

The lease involved in *Winship v. Wilkes,* 121 Cal. App. 44, 8 P. 2d 502, 504 (1932) contained an obligation to drill to a designated depth, "unless oil at a lesser depth is discovered in quantities deemed paying quantities by the lessee." The court held that the contract left the extent of discovery to the sound judgment and discretion of the lessee; but pointed out that such judgment could not be arbitrarily or unreasonably exercised. In referring to the meaning of the words "deemed paying . . . by the lessee" it said:

> "The words 'deemed by the lessee' need no construction. The word 'deem' is not an unusual word, nor has its use been confined to legal phraseology. It is a word in common use, and imports, in all of its shades, some idea of discretion and opinion. To deem is to think, judge, hold as an opinion, decide, or believe on consideration, to adjudge."

In *Cowden v. Broderick & Calvert,* 131 Tex. 434, 114 S.W. 2d 1166, 1171, 117 A.L.R. 61 (1938) the lease in question provided: "Lessor agrees that all other development shall be at the discretion of the lessee." The court held that the obligation thus expressed was not the same as "reasonable development" arising under the implied covenant and that "discretion" means freedom to act according to honest judgment. Accordingly, it was held that the trial court erred in sustaining a general de-

murrer to the petition of the plaintiff-lessor, which alleged that the lessees had not exercised their discretion in good faith but had abused such discretion in refusing to drill additional wells.

Dauer v. Sun Oil Co., 125 F. 2d 246, (5th Cir. 1942) was brought by the lessor to obtain an alternative decree against the assignee of the lease requiring it to proceed with development within "a reasonable time", or that the lease be terminated except as to areas surrounding existing wells. The lease provided that "the location of wells, extent of operation and all matters incidental thereto shall be only such as lessee in its business judgment deems best", and, further, that "there shall be no implied covenants read into this lease." The court pointed out that the express provision governing further development was controlling and that the prohibition against implying covenants merely emphasized such feature of the agreement. A judgment dismissing the action on motion of the defendants was therefore affirmed.

To the same effect see:

> *Adkins v. Adams,* 152 F. 2d 489, (7th Cir. 1945) (operations at such time and in such manner as lessee "may elect").
>
> *Skinner v. Ajax Portland Cement Co.,* 109 Kan. 72, 197 P. 875 (1921) ("entirely optional with the lessee" as to when it shall be obliged to drill).
>
> *Warren v. Amerada Petroleum Corp.*, 211 S.W. 2d 314 (Tex. Civ. App., 1948) (Operations to be conducted "at will" of lessee).
>
> *Gulf Production Co. v. Kishi*, 129 Tex. 487, 103 S.W. 2d 965 (1937) (number of wells designated).

In the final analysis, the foregoing authorities are nothing more than applications of the general law as to contracts requiring performance to the obligee's satisfaction.

> See Williston, Contracts, sec. 675A (Rev. Ed. 1936).

The Supreme Court of Montana recognized and applied the doctrine in *McCrimmon v. Murray*, 43 Mont. 457, 117 P. 73 (1911). There the plaintiff agreed to furnish defendant information concerning a vein of ore within the boundaries of a lode claim, for which defendant agreed to pay a certain percent of the selling price of the claim, if on investigation by defendant, the information should be "satisfactory" to him. The court held that defendant had the exclusive right to determine whether the information was satisfactory and that his judgment was controlling and to be deemed conclusive, though it was to be exercised honestly and in good faith.

See also: *Waite v. Shoemaker & Co.*
50 Mont. 264, 146 Pac. 736 (1915)

At the trial of this cause, appellees introduced evidence demonstrating their performance of the terms and conditions of the Fidelity Operating Agreement, which has been summarized in tabular form on pages 17, 18 of this brief. This evidence stands uncontradicted and unrefuted.

a. Appellants were required to plead and prove Fidelity's lack of good faith in exercising its discretion with reference to further exploratory drilling.

Appellants made no effort to assume and carry the burden of showing that appellees' activities failed to meet the test of good faith. They made no effort to show abuse of discretion. In the absence of such showing, appellees' performance must be deemed to have been accomplished in good faith. In fact, section 93-1301-7(19) R.C.M. 1947, creates a disputable presumption "that private transactions have been fair and regular." The law always presumes good faith, never fraud.

Greer v. Stannard
85 Mont. 78, 277 P. 622 (1929)
20 Am. Jur., Evidence, § 229, p. 223

The reply filed by appellants fails to allege bad faith or abuse of discretion. (Tr. 101-112) In *Magnolia Petroleum Co. v. Page*, 141 S.W. 2d 691 (Tex. Civ. App. 1940) the lease in question contained an express covenant providing that "The judgment of the lessee, where not fraudulently exercised, in carrying out the purpose of this lease, shall be conclusive". In the light of such provision, the court held that before lessors could recover, they must allege not only that lessee did not use due diligence but, also, that lessee had been guilty of bad faith.

b. Covenants will not be implied where the standard of development is expressly covered in the agreement.

In some of the cases cited, supra, in this section of the brief, an effort was made to have the courts imply covenants for development within a reasonable time, notwithstanding express agreements that development would be at discretion of lessee. Typical is the case of *Warren v. Amerada Petroleum Co.*, 211 S.W. 2d 314, 317, (Tex. Civ. App. 1948), where the lease gave the lessee the right "at will" to begin, abandon or resume operation. This quotation from the opinion is pertinent:

> "Appellant contends there is an implied covenant in the original lease between Bell and lessee to the effect that drilling must begin on the lease within a reasonable time. In the absence of an express stipulation in leases, the courts will imply a covenant to drill only in the event a reasonable, prudent operator would do so. But there is no room for an implied covenant where the lease contract itself makes the matter of development discretionary with lessee at his own will as was obviously the case in the original lease executed by Bell to lessee. The terms of that lease and the intention of the parties are clearly expressed in plain language and the courts will not undertake to write a new and different contract or to change the terms of one when the parties have stated their intentions clearly and in simple language. (c.c.) The original

> lease above referred to contains an express covenant which precludes the application of any implied covenant for prudent development or for development within a reasonable time." (c.c.)

The same conclusions were reached in other decisions where the leases authorized the lessee to use his discretion on future or further development.

Magnolia Petroleum Co. v. Page
141 S.W. 2d 691, 693, (Tex. Civ. App. 1940)

Gulf Production Co. v. Kishi
129 Tex. 487, 103 S.W. 2d 965, 970 (1937)

Cowden v. Broderick & Calvert
131 Tex. 434, 114 S.W. 2d 1166, 1171,
117 A.L.R. 61 (1938)

Adkins v. Adams
152 F. 2d 489, 491, (7th Cir. 1945)

It may be argued that it would be unreasonable to allow appellees the exercise of discretion, since this could result in no drilling at all. The application of the rule does not permit that situation to arise. It merely shifts the standard from "reasonable development" or "good oil field practice" to that of good faith judgment of appellees. This does not permit the use of arbitrary will or inconsiderate action, it is merely the freedom to act according to honest judgment. The acts of the appellees, culminating in the successful development of oil from Cedar Creek Anticline, are described in detail in the record. It is submitted they show the exercise of an honest judgment. This view is also consistent with an application of the rule that parties are free to contract; and courts will not make a new contract for them. See: *Dauer v. Sun Oil Co.; Cowden v. Broderick & Calvert;* and *Adkins v. Adams,* supra.

By way of summary, it is evident (1) that paragraph 4 of the Fidelity Operating Agreement vested Fidelity and its successors with the right to determine when further drilling was

to be accomplished; (2) that such determination is controlling and conclusive in the absence of bad faith or abuse of discretion; (3) that appellants failed to assume and carry the burden of showing bad faith or abuse of discretion; and (4) covenants will not be implied to defeat the expressed intent of the parties.

In the briefs before the trial court the appellants' argument on construction of paragraph 4 was directed primarily to its automatic termination for failure to drill. Appellees countered that the maximum requirement for further drilling, after completing an uncommercial test well, was good oil field practice. The court found with appellees but concluded that performance could not be determined without testimony on good oil field practice. This determination indicated the necessity for further briefing which brought to appellees attention the cases cited on pages 44-50, supra, supporting the rule, that if the lessor agrees future development shall be at the discretion of the lessee, the standard of performance is the good faith judgment of the lessee and not the normally implied covenant of good oil field practice.

4.

Appellants were required to give notice of appellees' default occurring under express and implied duty to drill or develop.

Appellants contend there is an implied covenant, under the Fidelity Operating Agreement, to "explore, drill and develop the lands in question with reasonable diligence" and the court erred in failing to find that it had been breached. (Brief, 69-72)

Appellants cannot contend there is an implied obligation to diligently explore, drill and develop each tract covered by the many Fidelity Operating Agreements, for such claim would be contrary to the purpose and express provisions of the Fidel-

ity Operating Agreement. Under that agreement appellants are not entitled to development of their respective lands, until drilling has progressed to them from present productive areas. (Paragraph 5) Appellees agree that after discovery on the specific lands, reasonable diligence would be required as to further drilling thereon, under express or implied terms of the respective leases.

If appellants are referring to an implied covenant to explore and develop within the Cedar Creek Anticline, then it will be found that the proposed implied covenants, would conflict with paragraph 4 of the agreement. It provides that if the test well is nonproductive, Fidelity may "prosecute such further drilling . . . at such times as shall be deemed by it good oil field practice, having due regard that the drilling operations hereunder are purely exploratory and speculative . . ."

In section 3 of this brief at pages 48, 49, 50 appellees have shown that in the face of express covenants the law does not imply covenants.

(1) Notice under implied covenants.

Assuming, for purpose of argument, that the law of implied covenants is applicable to the case at bar, appellants cannot prevail. It is universally recognized that if a lessor desires to terminate a lease for breach of one or more of the implied covenants, he must notify the lessee and afford a reasonable opportunity to remedy the situation, even in cases where the lease is silent on the question of notice.

3 Summers, Oil and Gas, § 469, pp. 164-169.

58 C.J.S. § 205 (2) (a), p. 514.

Berthelote v. Loy Oil Company, 95 Mont. 434, 446, 28 P. (2d) 187 (1933) cited by appellants, is a leading Montana case on the law of implied covenants. Appellants in citing this

case failed to reveal that notice of forfeiture was given. Furthermore, the court indicated that before a breach of an implied covenant could be claimed as substantial, the necessity for protecting the leased premises from drainage must be brought home to the lessee in some manner by reasonable notice or demand on the part of the lessor.

In an opinion of the supreme court handed down June 17, 1955, *Fey v. A. A. Oil Corporation,* .... Mont. ...., 285 P. (2d) 578, 586, it was said with reference to forfeiture of an oil and gas lease: "The rule is clear that the lessor who intends to claim forfeiture, where development is an element, has the duty to demand that development proceed or commence."

It has also been held that a notice to forfeit an operating agreement is not sufficient where it fails to specify the particular way or manner in which there has been a failure to comply with the agreement. On this point it was said in *Atlantic-Pacific Oil Co. v. Gas Development Co.,* 105 Mont. 1, 26, 69 P. (2d) 750 (1937):

> "Wight, in conjunction with the permittees, gave the notices of cancellation, and, in giving the notices, assigned no reason for the act, nor specified the particular manner or way in which the plaintiff had failed to comply with any provisions of the agreements. Before any right to cancel could arise or be exercised, we think it was necessary that Wight, and possibly the permittees, give timely notice and call attention or show wherein Stokes or his assignees had failed to comply with such agreements."

Appellants express the view that *Sauder v. Mid-Continent Petroleum Co.,* 292 U.S. 272, 54 S. Ct. 671, is "a case in which the facts are strikingly similar to those" before this court. (Brief, 71) The facts of the Sauder case are not similar. In it the Supreme Court was dealing with an ordinary oil and gas lease. Lessee had held it for 17 years and had drilled two

offset wells which were small producers. The leased lands consisted of 360 acres. At the expiration of the primary ten-year term lessor gave notice of cancellation for failure to develop and the lessee refused to drill additional wells. In response, the lessee expressly stated that it was not willing to drill a well. Even under these circumstances, the Supreme Court of the United States held that, so justice might be done, defendant should be given an opportunity to correct the breach complained of before having its lease cancelled.

Brewster v. Lanyon Zinc Company, 140 Fed. 801, and *Berthelote v. Loy Oil Co.*, 95 Mont. 434, 28 P. (2d) 187, were decisions, where there had been discovery under an oil and gas lease but no further development. They are like the Sauder case. The rulings in these cases would be more applicable if appellees had drilled a producing well on lands covered by a specific Fidelity Operating Agreement and then refused to develop the balance of the acreage.

(2) Under expressed covenants.

Paragraph 2 of Fidelity Operating Agreement provides in part as follows:

> "Forfeiture of all of the rights of second party as to respective lands upon which it shall be in default in the performance of the drilling, operating or producing obligations under this agreement and its failure to proceed to remedy such default within thirty (30) days after receipt of written notice from first party thereof, shall be the exclusive remedy of first party against second party on account of any such default hereunder; and default in drilling of the test well as hereinafter provided shall be deemed default as to all of the lands subject thereto."

It is conceded that the test well was drilled within the time provided and in accordance with the requirements of the Fidelity Operating Agreement. Further drilling on the structure was to

be prosecuted as deemed by Fidelity to be good oil field practice having due regard that the drilling operation was purely exploratory and speculative. It is here that appellants claim there was a default. Appellees say there was compliance, but if appellants considered them in default, they were entitled to notice under paragraph 2 and the general rules governing forfeiture.

The situation is not unlike that considered in *Consolidated Gas Co. v. Rieckhoff,* 116 Mont. 1, 6, 151 Pac. (2d) 588 (1944). The lease called for commencement of a well in two years. The term was extended and within the extended term a well was commenced. It was also provided that drilling would be prosecuted with due diligence to a certain horizon and in case of failure in that respect the lease would terminate, after written notice specifying the default unless the default was remedied in thirty days. The court in holding the complaint did not state a cause of action because it failed to allege the giving of notice said:

> "Since there is no question but that the well was commenced in time, the only thing which can operate to terminate the contract would be a breach of the covenant to diligently perform. Before the question of diligence can be litigated, the plaintiff must, under the terms of the agreement, allege and prove that a notice of default was given and no sufficient effort to remedy the default was made. This was not done and we must therefore hold that the complaint fails to state facts to constitute a cause of action."

This rule was again affirmed by our supreme court in *Fey v. A. A. Oil Corp.,* .... Mont. ...., 285 P. (2d) 578, 586 (1955). After recognizing that the policy of the law is to favor forfeiture of oil and gas leases the court said: "still 'One who seeks to enforce a forfeiture must himself be free from blame'. 37 C.J.S., Forfeitures, § 5 a, p. 11. The rule is clear that the lessor who intends to claim forfeiture, where development is

an element, has the duty to demand that development proceed or commence."

The rationale represented by the quoted language constitutes the general rule:

58 C.J.S., Mines and Minerals, § 205 (2) (a), p. 514.

3 Summers, Oil and Gas, § 469, pp. 163-167.

Furthermore, it is universally recognized that where contracts specifically provide that the remedies enumerated therein shall be the only course of action, parties to it are limited to the remedies provided therein.

Wing v. Brasher
59 Mont. 10, 20, 194 Pac. 1106 (1921);

J. M. Hamilton Co. v. Battson
99 Mont. 583, 44 P. (2d) 1064 (1935);

White v. Jewett
106 Mont. 416, 78 P. (2d) 85 (1938);

17 C.J.S. Contracts, § 523, p. 1145

The trial court found by Finding of Fact XXVIII, that:

> "At no time have the plaintiffs, or any of them, served a written notice of default upon any of the defendants, with respect to the performance of drilling, operating or producing obligations of the Fidelity Operating Agreements." (Tr. 198)

However, in the memorandum the court, after considering the effect of paragraph 4, said:

> "The forfeiture clause in Paragraph 2 would have no application to this situation, because the clause provides for notice of forfeiture only in case of default in drilling, operating or producing obligations, and as stated before, there was no obligation on Fidelity to drill, if the test well was unsuccessful. It is not reasonable to believe plaintiffs would accede to any such arrangement, and only by holding that Paragraph 4 granted an option can a reasonable result be arrived at." (Tr. 174)

Appellees contend this is too strict an interpretation of para-

graph 2 and especially the word "obligation". Following section 13-707 R.C.M. 1947 and looking to the whole contract, "so as to give effect to every part", it appears that the reference in paragraph 2 to "obligation" was not intended to cover only obligations, covenants, and absolute duties for which damages might have been claimed upon breach. While it is true Fidelity could not have been sued for damages for its failure to drill additional wells after the uncommercial test, its failure to do so would have been cause for forfeiture of its rights under the Fidelity Operating Agreement. The drilling after an uncommercial test well was in the nature of a conditional obligation or more specifically a condition subsequent. This placed a "duty" or "obligation" on Fidelity to drill in accordance with its fair and honest judgment as to what was good oil field practice, if it were to retain the rights and estate acquired through the agreements and the drilling of a test well.

The codes of Montana define most of the words and terms under consideration:

Obligation is defined in section 58-101 as: "An obligation is a legal duty, by which a person is bound to do or not to do a certain thing."

Next of importance is section 58-204 dealing with conditional obligations. It provides: "An obligation is conditional, when the rights or duties of any party thereto depend upon the occurrence of an uncertain event."

And section 58-205 sets forth the kinds of conditions as follows: "Conditions may be precedent, concurrent, or subsequent."

Of importance also is the definition of "condition subsequent" found in section 58-208. It provides: "A condition subsequent is one referring to a future event, upon the happening of which the obligation becomes no longer binding upon the other party, if he chooses to avail himself of the condition."

In determining whether a particular provision is a condition or a covenant the intention of the parties is to be determined from the agreement. See *Atlantic-Pacific Oil Co. v. Gas Dev. Co.*, 105 Mont. 1, 18, 20, 69 P. (2d) 750 (1937). This case also defines a "covenant" in the exact statutory language of section 58-101, namely: "an agreement between the parties to do or not to do a particular act".

In addition to preliminary geological examination and drilling of a test well as required in paragraph 3, further drilling was to be done in event of production from a test well under paragraph 5, and also if the test well was uncommercial as provided in paragraph 4. There appears to be no logical reason why the parties would provide for notice of forfeiture in the instance of drilling pertaining to the test well and not the others. The word "obligation" is to be understood in its "ordinary and popular sense, rather than according to . . . strict legal meaning." This is the mandate of section 13-710, R.C.M. 1947, which provides:

> "The words of a contract are to be understood in their ordinary and popular sense, rather than according to their strict legal meaning, unless used by the parties in a technical sense, or unless a special meaning is given to them by usage, in which case the latter must be followed."

The forfeiture clause deals first with the "respective" lands under agreement in providing: "Forfeiture of all rights . . . as to *respective lands* upon which it shall be in default in the performance of the drilling, operating or producing operations . . ." may be forfeited on notice. Then follows this special provision about the failure to drill the test well; "and default in drilling of the test well . . . shall be deemed default as to all lands . . ."

Appellants at pages 70 and 71 of their brief, cite the case of *Brewster v. Lanyon Zinc Co.*, 140 F. 801, 812 (8th Cir. 1905)

with reference to implied covenants. The Brewster decision supports the appellees' interpretation of the forfeiture clause. The forfeiture clause of the Fidelity Operating Agreement refers to "obligations" and appellees contend it also includes "conditions". In the Brewster case the forfeiture clause referred to "any of the above conditions" and it was contended that this did not include "covenants". The court held that in determining scope and effect of the forfeiture clause it must look "not merely to the letter, but to the spirit and legal effect" of the entire agreement. Accordingly the court held, that the provisions for forfeiture referred to the expressed and implied covenants of the lease, including the implied covenants for reasonable development. The portion of the opinion on this point reads:

> "But, however this may be, the present insistence is not well grounded. The question is essentially one of intention (c.c.) and the words 'any of the above conditions' must be given effect in the sense in which they were used by the parties. They are very comprehensive, and were evidently designed to refer, not merely to the letter, but to the spirit and legal effect of the preceding stipulations, and therefore to every covenant of the lessee which is part of them. The error in the insistence to the contrary is that it fails to give effect to the well-established rule that a covenant arising by necessary implication is as much a part of the contract —is as effectually one of its terms—as if it had been plainly expressed. (c.c.)
>
> "The conclusion is that compliance with a covenant to continue with reasonable diligence the work of exploration, development, and production after the expiration of the five-year period, if during that time oil and gas, one or both, be found in paying quantities, is by the terms employed made a condition the breach of which entitles the lessor to avoid the lease."

The *Brewster* decision was considered in *Gulf Production Co. v. Kishi,* 103 S.W. 2d 965, 970, 971, 129 Tex. 487 (1937). In the Kishi case the court refused to imply covenants for develop-

ment as the lease specified the number of wells. What was said by the court with reference to an implied covenant to develop, applies with equal force to an express condition such as paragraph 4 of the Fidelity agreements:

> "Because of the peculiar nature of the estate created by an oil and gas lease, the implied covenant for development is not a true covenant; that is, it does not impose a continuing, enforceable duty. The lessee may elect to permit the lease to terminate by ceasing to devote the premises to the purpose of oil and gas exploration, development, and production and thereby rid himself of the implied obligation, but the obligation continues as long as the lease is kept alive. . . . The express stipulation for development contained in the leases and the covenant for development implied in the absence of express stipulation have in a practical sense the same purpose, the development of the leased premises, and the obligation imposed by the express stipulations, like that implied, exists only while the lease is kept alive."

John Wight, who has been the moving spirit in this litigation, was well aware of the forfeiture clause contained in paragraph 2. On September 12, 1952, in writing to George H. Seivers, Secretary-Treasurer of Cedar Creek Oil and Gas Company concerning a form of notice to be sent to Fidelity, he cautioned:

> "You should be very careful, though, if you change any of the wording so that you are not declaring a forfeiture at this time because, if so, that would give them the right to go in and cure the defect by commencing the drilling a deep test well which, of course, they would be glad to do." (Ex. 6, Tr. 328)

5.

The Fidelity Operating Agreements have not, as claimed by appellants, expired under their own terms.

(1) This contention is contrary to expressed provisions of paragraph 4 and inconsistent

with other provisions of Fidelity Operating Agreement.

The burden of appellants' argument appears to rest on a strained effort to show an expressed limit under paragraph 4 requiring a well each year. Appellants would have the court decree that the words "good oil field practice" found in paragraph 4 relate only to "weather, season and roads". (Brief, 60) The last paragraph of page 60 lightly suggests that since drilling of the test well had to commence within one year from the execution of the operating agreements, there had to be under paragraph 4 at least one well a year.

The whole of a contract must be considered together under section 13-707, R.C.M., 1947, which provides:

> "The whole of the contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the other."

Citing the quoted section, the Supreme Court of Montana in *State v. Rosman,* 84 Mont. 207, 217, 274 Pac. 850 (1929), said:

> "In the interpretation of this contract we must call to our aid certain elementary rules. The intention of the parties is to be pursued if possible . . . This intention is to be gathered from the entire agreement, *not from particular words or phrases* or disjointed or particular parts of it."

When the parties wished to express fixed drilling limitations they found no difficulty. Thus we see in paragraph 3 with reference to drilling of the test well a specific provision that "second party will commence drilling operations for drilling such well within *one year* from the date of execution of operating agreements . . ." Again in paragraph 5, which provides for further drilling after commercial production is found on the structure, further drilling must be commenced in Units 2, 3, 4 or 5, "within *one year* after completion of such first commercial oil well." Why was not similar language used in para-

graph 4, if the parties intended to require drilling in one year? Appellants' argument is not only inconsistent with the other provisions of the Fidelity Operaitng Agreement but is contrary to the express provisions of paragraph 4 wherein it states; that further drilling shall be "at such times as shall be deemed by it to be good oil field practice, . . ."

Appellees frankly confess ~~liability~~ inability to follow appellants' argument that the reference in paragraph 4 to good oil field practice seems "clearly to relate to weather, season and roads." The obvious purpose of this provision was to avoid costly and almost impossible drilling conditions in wide open spaces of Cedar Creek Anticline during winter months.

(2) The conduct of appellee Fidelity Gas Company in its operations in 1936 to 1938 was in compliance with paragraphs 3 and 5.

The appellants argue that the promptness with which Fidelity commenced the Warren well in Unit 5, while not required under the agreement, nevertheless indicates Fidelity's construction of its terms. The N. P. No. 1 well had shows of oil from two horizons and produced some oil. (Tr. 543-544) Oil was encountered in the Smith No. 1 well. There was testing, swabbing and pumping tests to ascertain if the production was commercial until July or August, 1938. (Tr. 545) The oil was of low grade, about 32 gravity and there was no market for it. (Tr. 546) It is understandable that Fidelity not knowing if the N. P. No. 1 well would prove commercial proceeded to comply with paragraph 5 by drilling the Warren well within Units 2, 3, 4 or 5. This was a prudent precaution since there was a period of uncertainty as to commercial productivity from the time the N. P. No. 1 well was equipped for pumping on October 10, 1936 (Tr. 543) until 1938 when testing was completed and it was determined that the production was not commercial.

(3) Paragraph 4 of the Fidelity Operating Agreement is not ambiguous, and rules of construction proposed by appellants are not applicable.

Appellants' pleadings, proof and brief fail to indicate wherein the ambiguity occurs. The brief of appellants merely assumes that there is ambiguity. True, no automatic termination clause was included in paragraph 4, as appellants would now like to insert. However, this agreement must stand as written and new provisions cannot be read into it under the guise of ambiguity. Since this is true the argument about rules of interpretation is of little value. However, brief references will be made to those discussed in appellants' brief.

(4) Reply to appellants' argument that contracts are interpreted against the scrivener.

Appellants' brief refers to a number of authorities for the "scrivener rule", which we will not consider in detail, in view of section 13-720, R.C.M. 1947, which limits its applicability to cases of uncertainty. It provides:

> "In cases of uncertainty not removed by the preceding rules, the language of a contract should be interpreted most strongly against the party who caused the uncertainty to exist."

There is no uncertainty in paragraph 4 of the Fidelity Operating Agreement. (For further discussion see pages 71, 72, infra).

(5) Reply to appellants' argument that oil and gas leases are to be construed against the lessee and forfeiture thereof is favored.

The argument for the strict rule of forfeiture and interpretation is based on the false assumption that the Fidelity Operating Agreement is an oil and gas lease.

This is an operating agreement for exploration and development of the deeper sands in the Cedar Creek Anticline, including

acreage in which appellants have working interests. They are not landowner lessors as in the case of the ordinary oil and gas lessor. The terms of this agreement are to be construed as an ordinary contract. The rule against forfeiture is applicable; not the exception applied in favor of lessors in oil and gas leases. These statements are all substantiated by the opinion in *Cedar Creek Oil & Gas Co. v. Archer,* 112 Mont. 477, 481, 483, 117 P. (2d) 265 (1941).

Under the Fidelity Operating Agreement appellants subjected "all of the rights, interest and estate owned . . . under the lease, permits and agreements" on described lands. It follows that appellants are not in the position of landowner lessors considered in the *McDaniel* and other cases cited by appellants. Here we have a situation like that considered in the *Cedar Creek* case. After pointing out that there was no little controversy as to whether the operating agreement under consideration should be legally classified "as an operating agreement or a sublease" the court concluded:

> "We are furthermore of the opinion that irrespective of how the drilling agreement may be classified, its terms must be applied in accordance with the general rules and the laws relating to ordinary contracts."

It was argued as here that the court should apply the rule of forfeiture strictly against the lessee as in the case of an ordinary oil and gas lease. In rejecting the argument the court said:

> "It logically follows that, *in our opinion, the trial court was in error where, in its findings of fact, the plaintiff was given the status of a landowner lessor and as one entitled to the benefit of the exception to the general rule relating to forfeiture as applied in oil and gas leases in favor of the lessor,* which is discussed at length in the case of Solberg v. Sunburst Oil & Gas Co., 76 Mont. 254, 246 Pac. 168, and a number of other cases decided by this court, in which the rule referred to was mentioned and applied. (See Severson

> v. Barstow, 103 Mont. 526, 63 Pac. (2d) 1022; Berthelote v. Loy Oil Co., 95 Mont. 434, 28 Pac. (2d) 187; Abell v. Bishop, 86 Mont. 478, 284 Pac. 525; McDaniel v. Hager-Stevenson Oil Co., 75 Mont. 356, 243 Pac. 582)."

It is worthy of note that the court referred to the decisions in Solberg, Abell and McDaniel cases, relied on by these appellants, as being inapplicable to the cancellation and forfeiture of an operating agreement.

Another decision which held an agreement somewhat similar to the Fidelity Operating Agreement to be an operating agreement is *Aronow v. Hill,* 87 Mont. 153, 157, 286 Pac. 140 (1930). It is of special interest since it involved an agreement between a permittee and an oil company to prospect the property in accordance with the requirements of the United States, pay rentals and royalties due the government and divide the oil and gas as specified. Some of these appellants have operating agreements with permittees of government land.

6.

The court's finding and conclusion that appellees have not abandoned their rights under the Fidelity Agreement are strongly supported by the evidence.

The appellants ask this Court to set aside the trial court's finding (Finding XXII, Tr. 196), that the appellees did not abandon their rights under the Fidelity Operating Agreement. This they do despite Rule 52(a), which they recognize as existing, and then acknowledge that; "There is sharp conflict in the version these witnesses give of the conversations . . ." (Brief, 73) That the trial court carefully considered the evidence before adopting Finding of Fact XXII is clear from the section devoted to the question in the Memorandum, (Tr. 177-178) part of which reads:

"However, from a review of the decisions on abandonment, it is clear that intent to abandon must be shown before abandonment can be found. In this case while there is contradicted evidence that statements were made by officials of defendants Fidelity Gas Company and Montana-Dakota Utilities Company to the effect that those companies were through with deep drilling on the Cedar Creek Anticline, such evidence was unconvincing. Furthermore, there is uncontradicted evidence that all during the time when the abandonment is alleged to have taken place, Fidelity Gas Company was negotiating with various companies for the development of the anticline. These negotiations, established not only by the testimony of officials of defendant Fidelity Gas Company, but also by testimony of disinterested employees of the concerns with whom the negotiations were had, completely negates any intent on the part of Fidelity Gas Company to abandon their agreements."

Seldom will a case be found where the following words of caution given by this Court in *Hunter Douglas Corp. v. Lando Products*, 235 F. 2d 631, (1956) apply so aptly:

"Strong almost to the point of vehemence is the expression 'clearly erroneous'. An appellate court should bear this in mind when it applies Rule 52(a) of the Federal Rules of Civil Procedure, 28 U.S.C.A., which provides that "In all actions tried upon the facts without a jury . . . findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses.

"Too often appellate courts give only lip-service to the rule that, 'having seen and heard the witnesses, the trial judge is in a better position than an appellate court to pass upon the facts.' Too often reviewing tribunals are tempted to substitute their own fact-judgments for those of the courts of first instance.

"This is a pit into which this Court, with more or less success, has always endeavored not to fall."

Well might the argument be concluded at this point resting

on the admitted fact that the trial court, after hearing the conflicting evidence, found contrary to appellants' contentions. However, the record clearly sustains the correctness of the court's finding and reference thereto will be made.

(1) Facts concerning abandonment question.

Appellants admit having the burden of proving that Fidelity abandoned the Fidelity Operating Agreements. They argue that abandonment took place in 1938. This is based on the testimony of Wight, Jirik and Seivers. (Brief, 73-80)

Wight, who has an admitted interest in the profits accruing to Cedar Creek, Haney and Smith (Exhibits 17, 18, 19) and indirect interests in the other causes of action, assumed the principal burden of this phase of the evidence. (Tr. 308-312) On his deposition he testified to one trip to Minneapolis early in 1937; that he was in R. M. Heskett's office on that trip three or four times; and Heskett told him they were through drilling. (Tr. 345) Wight also testified on deposition that on one of those occasions George Norbeck was present and on another B. E. Terry accompanied him. (Tr. 340)

At the trial he did not remember that anyone was present except Heskett and he. (Tr. 339-340) On cross-examination he admitted that Norbeck and Terry were present (Tr. 340-341), and excused his shift in testimony between deposition and trial by explaining that before his deposition he had been going through records to refresh his memory. (Tr. 341) Wight believes Norbeck and Terry are deceased. (Tr. 341)

At the trial he remembered having talked to Heskett not only early in 1937, as testified at the time of deposition, but in the fall of 1937 and the spring of 1938. (Tr. 342) When confronted with his deposition and his failure to mention but one visit early in 1937, he excused himself by saying that he

had refreshed his memory from old files since the deposition. (Tr. 346-347) Let us see what Wight came up with to so clearly refresh his memory, that he visited with Heskett on two or more occasions than he could remember in 1953, when his deposition was taken: Two cancelled checks, one dated April 8, 1938 to the Nicollet Hotel and another to the Powhatan Hotel of Washington, D.C., August 13, 1937. (Exhiibts 22, 23) (Tr. 350-352) These two checks lighted up some recess of Mr. Wight's memory on the important question of abandonment, which was totally dark at the time of the deposition. This evidence recalls the occasion of the witness who testified that he saw an elephant climb a telephone pole and to prove it, offered the telephone pole in evidence.

Witness, John Wight, has a vital interest under agreements to share in the profits if this action is successful. (Ex. 17, 18, 19) His very direct interest is apparent to all who read the record. In fact, he is the only one who will lose if the suit is unsuccessful, for it is he who pays the costs and attorneys fees and saves the contracting parties harmless. In the Cedar Creek profit-sharing agreement with Wight, (Exhibit 17), it is recited that Wight "believes he does possess sufficient evidence, knowledge and facts to enable said action to be successfully prosecuted and terminated." The trial court not only had the benefit of hearing the testimony but in addition was able to observe the demeanor of the witness as he attempted to explain discrepancies in testimony given on deposition and at trial.

Jirik, at the trial testified to a short visit with Heskett late in 1937; that he saw Smith the same day and was told by each that Fidelity stockholders were complaining about spending so much money, and they were through drilling. (Tr. 415) He also testified to two other conversations with Smith. Although considerable effort was made to have him fix the dates he never

got closer than late in 1937, sometime after the first of the year 1938, and again toward the end of February, 1938. Seivers was present at the last visit. (Tr. 440) It appears that when his deposition was taken in Billings (at the same time as the Wight deposition) Jirik, like Wight, recalled but one conversation in 1937, but could not give the month. (Tr. 441-442) The trial court undoubtedly considered the coincidence that the memory of each would become so much clearer at trial than on the deposition.

Mr. Jirik apparently had no cancelled checks, but he brought a corroborating witness, George H. Seivers, secretary and treasurer of Cedar Creek Oil and Gas Company. (Tr. 452-454) It is safe to say that Mr. Seivers' testimony was refuted in every particular by his own deposition. At the trial he testified about being present with Jirik and Smith in 1938, shortly after he became secretary-treasurer of Cedar Creek, when Smith said Fidelity had abandoned drilling. (Tr. 452) In his deposition he said that he had no conversations about deep drilling for oil. (Tr. 463-464) In his deposition he said he became secretary and treasurer in 1948. (Tr. 459) At the conclusion of redirect examination counsel was given permission to recall Mr. Seivers as to the date he became secretary-treasurer. (Tr. 472) Mr. Seivers was not recalled.

Heskett and Smith denied having made the statements concerning abandonment of the Fidelity Operating Agreements. (Tr. 626, 567, 569, 570) Their testimony is supported by facts much more concrete than cancelled checks. Exhibit 12 is a letter dated November 1, 1937, from Cecil W. Smith to John Wight giving a report on production from N. P. No. 1 and Smith No. 1 wells. The letter concluded: "We expect, as soon as conditions permit, to deepen the #1 N. P. No. 1 well as it is felt that possibilities for additional lower producing zones are good."

In referring to #3 Smith No. 1 well, the letter stated: "Pumping was begun on May 22, 1937, and has continued since."

This letter covered the period of two of Wight's alleged visits —early in 1937 and August 1937. It was written about the time Jirik testified he called on Heskett and Smith. Here is recorded evidence by Mr. Smith that he still had hopes of good production at a lower depth to which drilling would be carried on in N. P. No. 1. Is it reasonable that he was, at the same time, telling Wight or Jirik that Fidelity was all through? The letter refutes any intention to abandon.

Herman F. Davies of the California Exploration Company testified as to frequent visits with Heskett and Smith from 1936 until late in 1938, negotiating on behalf of The California Company for the interest in the Fidelity Operating Agreements; and that in October and November, 1938, geophysical seismic work was done in Cedar Creek Anticline by his company. Negotiations were concluded by letter of January 9, 1939, from The California Company to Mr. Heskett. (Ex. 42, Tr. 510-511) It is not reasonable that competent businessmen would be attempting to agree to deliver an interest in oil and gas rights they were then abandoning or had abandoned.

Subsequently in an agreement dated November 27, 1940, Fidelity gave The Carter Oil Company the right to acquire an interest in the Fidelity Operating Agreement covering Gas Units 1 to 7, inclusive. (Ex. 44) This negatives any intent to abandon. The same is true of the agreements with Husky Refining Company, Exhibits 46, 47 and 48, and the Shell agreement, Exhibit 5.

There has been no showing of act and intent of Fidelity to abandon Fidelity Operating Agreements. This is necessary to meet requirements laid down by the Montana Supreme Court from an early date through 1938, when it decided *Irion v. Hyde*, 107 Mont. 84, 91, 81 P. (2d) 353.

(2) The law concerning abandonment.

Having discussed the facts on this phase of the case, appellees feel that the distinction between "abandonment" and "forfeiture" should be pointed out. As indicated in the trial court's memorandum (Tr. 177) courts have frequently used these terms "inexactly and interchangeably" in deciding oil and gas lease cases. In the field involving oil and gas leases we find the greatest laxity in the use of the term "abandonment" when "forfeiture" is intended. The subject is well covered by Professor Merrill in his work, "Covenants Implied in Oil and Gas Leases", second edition, pp. 28-34.

The Oklahoma case of *Berton v. Coss*, 280 Pac. 1093, 139 Okl. 42 (1929) is cited in appellants' brief page 83. As will be seen this decision no longer expresses the view of the Oklahoma court.

In the *Berton case,* lessee brought an action to establish title to an oil and gas lease. The lease was dated in 1920 for a primary term of 14 months and required a yearly payment of $300.00 for each well where gas only was found. A gas well was drilled and gas was produced for a short time. This well began producing water with the gas. There was an attempt made to pull the casing, but it was never completed. There was some evidence that lessee intended to drill a second well, but he never did. The court held that the lease was valid in the inception, but there was a breach of implied covenants to properly develop the lease premises, which justified the court in holding that the lease was no longer valid. The quoted statement on abandonment was made in the opinion. However, the decision actually rested on breach of implied covenants.

By 1943 the Oklahoma court found its decisions in a hopeless state of confusion. No distinction had been made between forfeiture and abandonment. In a "confession of confusion" the

opinion in *Doss Oil Royalty Co. v. Texas Co.*, 192 Okl. 359, 137 P. (2d) 934, 937, 938, (1943) was written. Former decisions were reviewed including *Berton v. Coss.* With reference to the *Berton* case it was pointed out that the court mistakenly referred to abandonment when it was actually considering forfeiture under an implied covenant. It follows from what is said in the *Doss* opinion that the *Berton* decision no longer stands as authority for the abandonment theory therein erroneously announced.

In *Hall v. Augur,* 82 Cal. A. 594, 256 P. 232, 235 (1927) the community lease specifically provided for the erection of a derrick in 30 days and commencement of a well 30 days thereafter. The lessee never did anything except erect a derrick. The court in holding the lease invalid referred to forfeiture and abandonment indiscriminately, and finally said: "The plaintiff had a right to forfeiture for conditions broken . . ."

The limits of this brief will not permit a discussion of the general principles governing abandonment established by the decisions of the Supreme Court of Montana. Reference will be made to them and consideration given to the case of *Hermon Hanson Oil Syndicate v. Bentz,* 77 N.D. 20, 40 N.W. (2d) 304, 306, 308 (1949), in the appendix.

7.

Paragraph 4 of the Fidelity Operating Agreement is not ambiguous and parol evidence concerning its provisions was properly excluded.

Specification of Error 14 is based on the court's refusal to permit John Wight to testify concerning discussions had prior to the execution of the Fidelity Operating Agreement, as to what would happen in the event the test well was not successful.

(Brief, 17-18) The appellants' argument rests on the uncertain and shaky premise that Paragraph 4, to quote from their brief, was "not so clear as to the time in which additional wells were to be drilled", (p. 18) and; "If the Trial Court is correct in finding there was ambiguity as to the time the option must be exercised . . ." (p. 67). As will be seen the trial court found there was no ambiguity.

In referring to the interpretation of paragraph 4, the trial court said in its memorandum opinion, "the court remains of the opinion that Paragraph 4 is not ambiguous, needs no explanation by way of oral evidence and that such evidence was properly excluded." Continuing, the court also found "The meaning of Paragraph 4 is clear when read in the light of the provision of the contract as a whole." (Tr. 172) And finally concluded with this statement, "In short, Paragraph 4 granted to Fidelity Gas Company the option to conduct further drilling operations, in the event the first test well was unsuccessful and further provided that the option so granted must be exercised within the time after the completion of the unsuccessful test well that good oil field practice in a wildcat area would require." (Tr. 173)

From the appellants' brief, and specifications of error this court would be led to believe, that the ruling had to do with only three questions and answers set forth under Specification of Error 14. Actually these were only preliminary to offers of proof. (Tr. 293, 364) The offers being quite similar the first is quoted:

> "The plaintiffs offer to prove through the witness on the stand that at the time the contract was negotiated, and during the discussions at the conference at Billings referred to by this witness, the question of the effect of unsuccessful testing or drilling program was discussed, and reference was made by one of the rep-

> resentatives of the Fidelity Gas Company to Paragraph 4 of the deep test agreement, and it was stated by the representative, and generally agreed that in the event the testing program was not successful, and in the event the testing program was terminated, that there would then be remaining in Fidelity Gas no rights under the contract, and that Section 4 was referred to as the section which had that effect." (Tr. 293)

The offer was refused after appellees' objection that: "it is incompetent, irrelevant and immaterial; there is no issue in this case, no pleading to reform this agreement, and that the witness is now attempting to vary the terms of the written instrument by conversations that took place during negotiations, no proper foundation laid." (Tr. 291, 293)

What appellants were attempting is revealed by counsels' statement to the court:

> "So the record will be clear, I would state that the purpose of this question and the testimony we had hoped to elicit is that at the time the contract was under negotiation, and in the study of the various provisions, the question came up as to what would happen if the deep test weren't successful, and the parties, both sides, said that would be the end of the contract. I don't believe that varies any term of the contract. That was the testimony we had hoped to elicit on this particular question." (Tr. 361-362)

Appellants seek to justify their position by asserting that Paragraph 4 is ambiguous and therefore falls within one of the exceptions as to the parol evidence rule. This rule and its exceptions, as codified by section 93-401-13, R.C.M. 1947, provides:

> "When the terms of an agreement have been reduced to writing by the parties, it is to be considered as containing all those terms, and therefore there can be between the parties and their representatives, or successors in interest, no evidence of the terms of the agreement other than the contents of the writing, except in the following cases:

> "1. Where a mistake or imperfection of the writing is put in issue by the pleadings.
>
> "2. Where the validity of the agreement is the fact in dispute.
>
> "But this section does not exclude other evidence of the circumstances under which the agreement was made, or to which it relates, as defined in section 93-401-17, or to explain an extrinsic ambiguity, or to establish illegality or fraud . . ."

It also is provided by section 13-607:

> "The execution of a contract in writing, whether the law requires it to be written or not, supersedes all the oral negotiations or stipulations concerning its matter which preceded or accompanied the execution of the instrument."

Appellants did not plead ambiguity in their reply. No effort to point out the ambiguity was made at the trial or in their brief. On the contrary, they content themselves with the bald, unexplained assertion that Paragraph 4 is ambiguous. Appellees feel this situation is covered by the rule stated in 17 C.J.S. Contracts, § 535b, p. 1159:

> "Where the contract is ambiguous, the pleader may and must remove the ambiguity by averring a definite meaning or construction of the ambiguous language . . . If a party wishes to introduce evidence explaining a written contract, he must plead the ambiguity making such testimony necessary."

The quoted principle is applicable to cases arising under section 93-401-13 R.C.M. 1947, adopted from California, where the enactment exists as section 1856, Code of Civil Procedure. In *Hotchkiss v. Nelson R. Thomas Agency, Inc.*, 96 Cal. App. (2d) 154, 214 P. (2d) 568, 570 (1950), the court, in speaking of the ambiguity exception to the parol evidence rule, said:

> "The case does not fall within the exceptions of section 1856 of the Code of Civil Procedure since the ambiguity was not put in issue by the pleadings nor was the validity of the contracts in dispute."

It is worthy of note that in *Brown v. Homestake Exploration Co.*, 98 Mont. 305, 323, 331, 39 Pac. (2d) 168 (1934) cited by appellants the complaint alleged the oral negotiations and agreements and the interpretation of the agreement for which he contended. Clearly, in the absence of specific allegations pointing to the ambiguity, appellants are precluded from raising the question.

We have heretofore shown that the obligation created by Paragraph 4 of the Fidelity Operating Agreement is clear and unambiguous; that the life of the agreement coincides with that of the underlying base oil and gas leases; and that the time and place for drilling additional test wells if the first proved uncommercial are matters governed by Fidelity's good faith judgment of good oil field practice. The trial court properly held Wight's offered testimony inadmissible because it constitutes an attempt to read a termination provision into a complete, integrated writing.

Appellants have stressed *Brown v. Homestake Exploration Co.*, supra, and stated that "the facts were most similar to those in instant case." (Brief, 68) Examination of the *Brown* case reveals that the only similarity springs from the fact that the Montana Supreme Court was dealing with an agreement for oil exploration. There the similarity ends. The agreement before the court in the *Brown* case obligated the defendant to drill wells "to such number and extent as said premises will admit of." The court sanctioned the admission of testimony to explain the number of wells contemplated by the quoted provision. In so doing, the Supreme Court of Montana did not add a provision to the agreement but merely permitted explanation of an existing provision in order to gauge the sufficiency of the defendant's performance. Obviously, this is a vastly different situation than is presented in this case. Here the proffered

testimony seeks to add a parol provision for automatic termination. Undoubtedly, the *Brown* case represents a logical application of the parol evidence rule. However, it cannot be distorted and applied in the manner appellants urge.

The applicable rule is appropriately summarized by the following language from the opinion of the Supreme Court of Montana in *McDaniel v. Hager-Stevenson Oil Co.*, 75 Mont. 356, 361, 243 Pac. 582 (1926):

> "A contract may not be changed or revised under the guise of interpretation. Where a contract is plain and clear in its terms, neither interpretation nor construction is permissible. (Citing Ming v. Pratt, 22 Mont. 262, 56 Pac. 279 and another Montana decision) When the language employed by the parties 'is free from ambiguity or uncertainty, it is beyond the power of the court to enlarge or restrict its application or meaning' (citation). And when the terms of a contract are plain and unambiguous, resort may not be had to extrinsic circumstances under the pretense of determining its meaning."

It is evident that the trial court did not err in ruling that Wight's offered testimony was inadmissible.

8.

Appellees are not estopped from claiming under the Fidelity Operating Agreements.

In support of their claim of estoppel, appellants rely entirely on statements of abandonment claimed to have been made by Fidelity officials to appellants in 1937 and 1938.

The trial court found that appellees did not abandon their rights under the Fidelity Operating Agreement (Finding XXII, Tr. 196) and stated that the evidence as to these statements "was unconvincing." (Tr. 177)

In just this situation, *Fiers v. Jacobson,* 123 Mont. 242, 211 P. 2d 968, 972 (1949) said:

"In Davis v. Davis, 26 Cal. 23, 85 Am. Dec. 157, at page 168, the Supreme Court of California said: 'We may say in respect to parol evidence of the declarations and admissions of persons made long anterior to the trial, upon which an estoppel in pais may be sought to be founded, that it cannot be too carefully scrutinized by courts and juries. In all cases, it is the most dangerous species of evidence that can be admitted in a court of justice, and the most liable to abuse. In most cases, it is impossible, however honest the witness may be, for him to give the exact words in which the declaration or admission was made. Sometimes even the transposition of the words of a party may give a meaning entirely different from that which was intended to be conveyed. The slightest mistake or failure of recollection may totally alter the effect of the declaration or admission. And more than this, it is most unsatisfactory evidence on account of the facility with which it may be fabricated, and the impossibility, generally, of contradicting it when false."

CONCLUSION

The trial court after hearing the witnesses and in the exercise of sound discretion entered judgment for the appellees. It is respectfully submitted that the judgment is supported by the court's findings in favor of the appellees on their defenses of laches, estoppel and waiver; the finding that appellants gave no notice of default under express or implied covenants to drill or develop; and the uncontraverted evidence that drilling and development were carried on by appellees under the Fidelity Operating Agreement in the exercise of good faith discretion as to good oil field practice.

Respectfully submitted,

Of Counsel:

Faegre & Benson
1260 Northwestern Bank Bldg.
Minneapolis 2, Minnesota

Coleman, Lamey & Crowley
500 Electric Building
Billings, Montana

Of Counsel for Defendant,
Shell Oil Company

Howard M. Gullickson
1700 Broadway
Denver, Colorado

Charles N. Wagner
1700 Broadway
Denver, Colorado

John C. Benson
Armin M. Johnson
Rodger Nordbye
1260 Northwestern Bank Bldg.
Minneapolis 2, Minnesota

Raymond Hildebrand
Glendive, Montana

Arthur F. Lamey
500 Electric Building
Billings, Montana

Attorneys for Appellees

Appendix 1

GENERAL PRINCIPLES OF ABANDONMENT

The general principles of "abandonment" have been frequently recognized in Montana through decisions involving mining claims and water rights. Some of those found in the decisions are:

a. The intent to abandon is the first and paramount requirement.

b. Abandonment must be made by the owner, without being pressed by any duty, necessity or utility to himself.

c. Mere lapse of time during which there is nonuser is not sufficient.

d. Abandonment must be made by the owner because he desires no longer to possess the same.

Irion v. Hyde
107 Mont. 84, 91, 81 Pac. (2d) 353 (1938);
Conway v. Fabian
108 Mont. 287, 306, 89 Pac. (2d) 1022 (1939)
Moore v. Sherman
52 Mont. 542, 545, 159 Pac. 966 (1916);
Featherman v. Hennessy
42 Mont. 535, 540, 113 Pac. 751 (1911).

Although many cases might be cited applying to development of oil and gas lands the distinction between forfeiture and abandonment, reference is made to only one lately decided by the North Dakota Supreme Court. It will indicate the application of the foregoing principles to a fact situation somewhat similar to this case. *Hermon Hanson Oil Syndicate v. Bentz, 77 N.D. 20,* 40 N.W. (2d) 304, 306, 308 (1949), was decided by the Supreme Court of North Dakota on October 31, 1949. In this case the Oil Syndicate, plaintiff, brought an action against Bentz, subsequent lessee, and the owners of the fee, successors in interest to the lessor of the Oil Syndicate, to quiet title to land which the Syndicate

held under a lease dated November 10, 1926. The Syndicate lease provided that it was taken as a part of a community lease and the facts disclosed that identical leases involving the community feature were obtained on 96,000 acres of land. The lease provided that "unless drilling shall begin on some part of this community lease within the specified five-year period then and in that case each one of the leases comprising this community lease shall become null and void."

The defendant's first contention was that the plaintiff abandoned its lease prior to the execution of the subsequent lease to Bentz. The records disclose that the plaintiff began drilling a well on a tract of land covered by the community lease other than the lease involved in the action in 1928. Actual drilling operations were suspended in the fall of 1933. The plaintiff had erected on the building site an office, two bunkhouses, a cook house and derrick, installed drilling machinery and purchased casing at an expense of over $29,000.00. The main well was drilled to a depth of 1840 feet. When drilling was suspended, the derrick was not removed, neither was the casing withdrawn from the well. The power plant consisting of a diesel unit was moved to a nearby farm and stored. The court found that the drilling equipment could be put into operation again within twenty-four hours and that suspension of drilling in 1932 (sic) was due to depletion of funds and that the plaintiff later undertook other operations with a view to procuring money with which to complete the well. These operations included the conduct of strip coal mining operations on land covered by the community lease in 1937 and 1939, experiments with extracting gold from gravel and, from time to time, making efforts to procure financing sufficient to enable the plaintiff to complete the well and continue exploration operations. In 1940, an application was made to the Securities Stock Exchange Commission

for permission to sell $300,000 worth of stock. During the war, the War Production Board sought to have the plaintiff scrap his equipment and pull up the casing, which the plaintiff refused to do and advised the Board the plaintiff intended to continue drilling. In 1945, a tentative contract was made with a driller which did not produce results. The plaintiff from time to time executed waivers of priority in favor of mortgagors to enable lessor to secure mortgages. The court also found that during World War II it was impossible for companies like the plaintiff to procure pipe for casing or equipment to carry on operations; that since the war the plaintiff had leased under the community lease approximately 10,000 acres in addition to the original 96,000; and that it had also leased approximately 10,000 acres from the state of North Dakota. Two officers of the plaintiff corporation testified that it was the intention of the corporation to continue operations and to drill the well to a sufficient depth to either be a producing well or a dry hole and to that end a tentative agreement had been reached with a drilling concern to proceed with the work.

On the basis of the above facts, the court found that there had been no abandonment of the property by the plaintiff, and stated:

> "The abandonment of property or an interest therein implies a voluntary relinquishment thereof. Intent is an essential element of abandonment. We have followed this general rule with respect to the rights of a vendee under a land purchase contract. (Citing case), and with respect to homestead rights, Larson v. Cole, N.D., 33 N.W. 2d 325; Grotberg v. First Nat. Bank, 54 N.D. 548, 210 N.W. 21. The same general rule is applicable where a lessor seeks to terminate an oil and gas lease on the ground that the lessee has abandoned it. Unless it appears either by direct evidence or preponderant circumstances that the lessee intended to abandon his lease, the courts will not declare it termi-

> nated on that ground. Intention of the lessee to abandon an oil lease is a requisite. (Citing cases) In Oklahoma a long line of cases emphasize the necessity of intent to relinquish as a basis for abandonment and in recent decisions a showing of intention to abandon accompanied by physical relinquishment is required. (Citing cases)

The *Bentz* case also discusses forfeiture and the necessity for notice.